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REFERENCES.

In the Supreme Court of the United States.

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY AND Fidelity-Phenix Fire Insurance Company of New York, Appellants,
v.
THE UNITED STATES OF AMERICA, Reading Company, The Philadelphia & Reading Coal & Iron Company, et al.
No. 609.

SEWARD PROSSER, MORTIMER N. BUCKNER, and JOHN H. MASON, as a committee representing holders of common stock of the Reading Company, Appellants,
v.
THE UNITED STATES OF AMERICA, Reading Company, Philadelphia & Reading Coal & Iron Company, et al.
No. 610.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR THE UNITED STATES ON REARGUMENT.

PRELIMINARY STATEMENT.

These are appeals by certain holders of the common stock of Reading Company from a decree of dissolution and injunction entered by the United States

District Court for the Eastern District of Pennsylvania pursuant to the mandate of this court in the case of *United States* v. *Reading Company et al.* (253 U. S. 26). The appeals were argued and submitted on the questions raised by the assignments of error—as to the relative rights of the common and preferred stockholders in the disposition of certain assets of Reading Company under the decree—and on February 27, 1922, were restored to the docket for reargument on the question whether said final decree conforms to the mandate of this court, and the attention of the Attorney General was directed to the order of restoration.

The plan of dissolution embraced in the decree of the lower court was worked out by counsel for the Government and counsel for the defendants after long-continued negotiations and after several conferences with the judges of the District Court. (Rec. 278–279.) The four main provisions of the decree are (*a*) merger of Reading Company and the Philadelphia & Reading Railway Company; (*b*) dissociation of Reading Company and the Philadelphia & Reading Coal & Iron Company; (*c*) disposition of the stock of the Central Railroad Company of New Jersey; (*d*) dissociation of the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company. In order to approach the questions as to which the court desires counsel to give special attention, it will be necessary to review each of these provisions, outlining the purpose thereof, the reasons

which led the Government to assent thereto, and the proceedings which have been had thereunder.

As stated, the only questions raised by the assignments of error relate to alleged conflicting rights of common and preferred stockholders, and the appeals operate as a supersedeas only as to the last step in the plan for the dissociation of Reading Company and Reading Coal Company, namely, the distribution of certain certificates of beneficial interest to common and preferred stockholders, share and share alike. (Rec. 314–325.) The remainder of the decree having been left undisturbed by the appeals, certain performances have been had thereunder, including the transfer to trustees of the interest of the Reading Company in the stock of the Jersey Central and the sale of the stock of the Lehigh & Wilkes-Barre Coal Company. The record on the present appeals was specially made up by stipulation of counsel and contains only data bearing on the questions raised by the assignments of error, so that in this brief it will be necessary to refer from time to time to the record on the former appeal (Nos. 3 and 4, October Term, 1919), which for convenience will be designated "Old Record."

DECISION AND MANDATE OF THIS COURT.

On the former appeal (253 U. S. 26, Rec. 1–26) this court held, in substance:

(1) That prior to 1896 the Philadelphia & Reading Rail*road* Company, through its subsidiary the Philadelphia & Reading Coal & Iron Company, acquired

more than two-thirds of the acreage of the Schuylk coal field "for the frankly avowed purpose, not th forbidden by statute, of monopolizing the produ tion, transportation, and sale of the anthracite co of the largest of the three sources of supply" (p 45, 56).

(2) That the conveyance pursuant to the reorgan zation scheme of 1896 of the properties formerl owned by the Philadelphia & Reading Rail*road* Com pany and the Philadelphia & Reading Coal & Iro Company to Reading Company, Philadelphia & Read ing Rail*way* Company and the Philadelphia & Read ing Coal & Iron Company "constituted a combina tion to unduly restrain interstate commerce withi the meaning of the (antitrust) act" (p. 48).

(3) That the great power centered in Reading Company was twice used "for the purpose of violat ing in a flagrant manner the antitrust act of 1890 * * * once successfully, to suppress the building of a prospective competitive railway line, and a second time, successfully until this court condemned the 65 per cent contracts as illegal, to suppress the last pros pect of competition in anthracite production and transportation" (pp. 50, 59).

(4) That the acquisition in 1901 by Reading Com pany of approximately 51 per cent of the capital stock of the Central Railroad Company of New Jersey, which in turn owned in excess of eleven-twelfths of the capital stock of the Lehigh & Wilkes-Barre Coal Company, "placed the holding company in a position

of dominating control not only over two great competing interstate railroad carriers but also over two great competing coal companies, engaged extensively in mining and selling anthracite coal, which must be transported to interstate markets over the controlled interstate lines of railway" (pp. 50–51, 57).

(5) In view of the intimate relations of the three Reading companies and the intermingling of their affairs the coal of the Philadelphia & Reading Coal & Iron Company was "produced under the same 'authority' that transported it over the railroad," within the meaning of the commodity clause of the act to regulate commerce, "and for violation of this commodity clause, as well as for its violation of the antitrust act, the combination between the Reading Railway Company and the Reading Coal Company must be dissolved" (pp. 61–62).

(6) That for like reasons the relation between the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company "falls within the condemnation of the commodities clause and this relation must also, for this reason, be dissolved" (p. 63).

After providing for the affirmance of the provisions of the decree of the District Court dismissing the Government's bill in certain unimportant particulars, and for the affirmance of other provisions of the decree canceling restrictive covenants in mining leases and requiring the dissolution of the combination between the Philadelphia & Reading Coal & Iron Company and the Lehigh & Wilkes-

Barre Coal Company, and for the dismissal of the bill as to the Wilmington & Northern Railroad Company and the individual defendants "without prejudice," the court made the following order with respect to "the really important defendants in the case" (pp. 63–64):

> As to the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, and the Central Railroad Company of New Jersey, the decree of the District Court will be reversed and the cause remanded with directions to enter a decree in conformity with this opinion, dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies held by the Reading Company as may be necessary to establish the entire independence from that company, and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the Central Railroad Company of New Jersey, and the Lehigh & Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh & Wilkes-Barre Coal Company, held by the Central Railroad Company of New

Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all these now combined companies may be conducted in harmony with the law.

PROCEEDINGS IN THE DISTRICT COURT.

Upon receipt of the mandate the District Court entered an interlocutory decree, called "decree on mandate," (*a*) finding and adjudicating that the defendants have violated the antitrust act and the commodities clause in the particulars above set forth; (*b*) reversing and setting aside the final decree theretofore entered by that court save in the particulars in which it was affirmed by this court; (*c*) providing that within a specified time the defendants should file a plan for the dissolution of the unlawful combination in accordance with the mandate; and (*d*) affording injunctive relief pending entry of a final decree. (Rec. 31–39.)

At the direction of the judges of the District Court, counsel for the defendants and counsel for the Government cooperated in the working out of a plan, and the judges were kept informed of the progress made at informal conferences which were held from time to time. (Op. Rec. 278.) On February 14, 1921, defendants filed a plan which was not opposed by the Government save in one particular. (Rec. 40–45.) The Government's opposition was directed to paragraph 8 of the plan providing for the trusteeing of Reading Company's interest in the capital stock of

the Central Railroad Company of New Jersey pending the formulation by the Interstate Commerce Commission of a regrouping plan for railroads pursuant to the transportation act of 1920. (Rec. 45–46.) It was the Government's position that as the decision of this court was handed down two months after the approval of the transportation act, it was the clear intention that the dissolution of the combination should be carried out regardless of that act.

On the same day the court entered an order directing that a copy of the plan and suggestions of the Government be served on the Central Union Trust Company of New York, trustee under the general mortgage, that copies be made available to the stockholders of Reading Company, and that counsel for the Government and for the defendants would be heard on March 1, 1921. (Rec. 46–47.) Copies of the plan and suggestions were sent to all stockholders of Reading Company. (Rec. 186–189.) The plan having contemplated the release of the stock and properties of the Philadelphia & Reading Coal & Iron Company from the lien of the general mortgage, the Government filed a supplemental bill to make the Central Union Trust Company a party to the suit. (Rec. 48–49.)

By March 1 there had been organized a committee representing the common stockholders, and another representing the preferred stockholders, and those committees, together with numerous other holders of the different classes of stocks and bonds, asked leave

to intervene in the cause for the protection of their interests. At the hearing counsel for the various common stockholders opposed the plan for the alleged reason, now familiar to this court, that it conferred on the preferred stockholders rights to which they were not entitled; counsel for the trustee and for the bondholders opposed the plan because it involved the disturbing of the security of the general mortgage; while counsel for the preferred stockholders favored the plan as just and equitable.

On April 12, 1921, the court entered a further order permitting these various interests to intervene as parties defendant (Rec. 203–205); and another order setting the cause down for hearing on May 2, 1921, upon the following questions:

> 1. (*a*) Whether the sale provided for in paragraph 5 of the Reading plan is such a disposition of the interest of Reading Company in the stock of the Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful; (*b*) and if the mandate is thereby complied with, whether such disposition confers upon any one class of stockholders of Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders.
>
> 2. Whether the stock of the coal company should be sold free from the lien of the general mortgage, or whether a sale of certificates of

interest therein would be a compliance with the provisions aforesaid of the mandate of the Supreme Court of the United States.

3. Whether the Reading Company should offer a premium of 10 per cent to the general mortgage bondholders for release of the coal company's property from the lien of the general mortgage, or whether the requirements of the mandate of the Supreme Court of the United States may be fulfilled by proper injunctive provisions in the decree to be entered in this cause. (Rec. 205–207.)

After the filing of said orders and before May 2 a modification of the plan was proposed by defendants and assented to by the Attorney General which obviated the necessity of any impairment of the security of the general mortgage. (Rec. 210–212; 279–280.) The objections of the trustee and of the bondholders thus having been eliminated,[1] the cause was heard on the questions propounded in the first paragraph of the court's order. On May 21, 1921, the court through Circuit Judge Buffington, handed down an opinion fully sustaining the modified plan as complying with the "letter and spirit of the mandate," and directing that it be embodied in a final decree. (Rec. 278; 273 Fed. 848.) Such final decree was entered June 6, 1921. (Rec. 287; 273 Fed. 854.)

On June 11, 1921, the District Court, pursuant to sections 3 and 4 of the decree, entered an order appointing trustees to hold Reading Company's in-

[1] The bondholders, therefore, are not represented directly but only through their trustee, and their rights were not passed on by the court below.

terest in the stock of Reading Coal Company and the Central Railroad Company of New Jersey. (Rec. 313.) By indenture dated August 29, 1921, all of the Reading Company's right, title, and interest in the stock of the Jersey Central was turned over to the trustees, who have voted such stock so as to bring about a complete reorganization of the Jersey Central board, of which they are now members. It having been deemed inadvisable to proceed with the plan for the dissociation of Reading Company and Reading Coal Company because of the pendency of these appeals, the coal company trustees have not actively assumed their duties but are temporarily serving as directors of that company.

On November 17, 1921, the Central Railroad Company of New Jersey, in accordance with section 8 of the decree, sold and disposed of all stock of the Lehigh & Wilkes-Barre Coal Company owned by it. One of the minority stockholders of the Jersey Central has filed an intervening petition with the District Court asking that the sale be set aside on the ground that it was not made to the highest bidder. But this court having taken jurisdiction of the whole case it is assumed that no proceedings will be had on this petition until these appeals are disposed of.

PROVISIONS OF THE PLAN.

Merger of Reading Company and the Philadelphia & Reading Railway Company.

As pointed out in the opinion of this court, the purchasers of the properties of the Philadelphia & Reading Rail*road* Company at the foreclosure sale in

1896 conveyed those properties to the Reading Company and the newly formed Philadelphia & Reading Rail*way* Company, as follows:

To Reading Company: (*a*) All real estate, including tidewater terminals at Philadelphia and on New York Harbor, but not including rights of way, depots, and yards; (*b*) all locomotives and rolling stock of every description; (*c*) all steam colliers, vessels, and other floating equipment; and (*d*) shares of stock and bonds of various short-line railroads forming integral parts of the Reading system.

To Reading Railway Company: All other property formerly owned by Reading Rail*road* Company consisting principally of rights of way, franchises, etc.

Following the decision of this court, application was made for a modification of the decree which would permit the Reading Company to retain the stock of either the Reading Railway Company or Reading Coal Company. But to allow Reading Company with its unlimited charter powers to retain either would have been wholly inconsistent with the decision. The application, therefore, was resisted by the United States and was denied by this court. (253 U. S. 478.)

Nevertheless, in order to insure the independence of the Reading Railway Company and to enable it to discharge its function as a public carrier, it was necessary that there should be conveyed to it the railroad equipment owned by Reading Company and pledged under the general mortgage. (Old Rec. Vol. IV, pp. 1665–1669.) Merely to have

required Reading Company to dispose of the "stocks, bonds, and other property" of the railway company held by it would not have sufficed unless the equipment acquired indirectly from the old rail*road* company could be regarded as coming within that category. For reasons hereinafter mentioned (*infra* pp. 18–20) it was deemed advisable to handle the matter with as little disturbance to the security of the general mortgage as would be consistent with an effective dissolution of the unlawful combination.

After considering and rejecting numerous proposals it was concluded that the relationship between the Reading Company and the Reading Railway could best be terminated by their merger into a new corporation having only the powers of a common carrier. With the Reading Company divested of its interest in the Jersey Central and Reading Coal Company such merger would not offend against either the antitrust law or the commodities clause; it was expressly authorized by article 10 of the general mortgage (Old Rec. Vol. IV, pp. 1734–1737); and with the assent of the Attorney General the proposal was embodied in the plan as paragraph 6. (Rec. 276.) When carried into effect it will result (*a*) in effectually terminating the relationship between Reading Company as a specially chartered holding company and Reading Railway Company; (*b*) in the surrender to the State of Pennsylvania of Reading Company's omnibus charter; (*c*) in the vesting in a new railroad company of the rights of way and franchises now owned by the Reading Railway and the

rolling stock and other equipment held by Readin Company, which company (*d*) will be in all respec subject to the regulation of State and Federal author ties as a common carrier, and (*e*) will expressly a cept the provisions of Article XVII of the Pennsy vania Constitution of 1874.

Dissociation of Reading Company and Reading Coal Compan

First plan.—In *United States* v. *Union Pacific Com pany* (226 U. S. 470), this court held that it would no be a sufficient compliance with the antitrust law fo the Union Pacific Company, in disposing of the stock o the Southern Pacific Company, to distribute suc stocks pro rata to its stockholders. Throughout th negotiations in reference to the plan the Attorney Gen eral insisted that the principle of that decision shoul govern in the dissolution of the present combination The Attorney General's view was acceded to by th defendants and, accordingly, the plan provides fo the disposition of the Reading Company's interest i the stock of the Reading Coal Company to person not stockholders of the Reading Company, th method employed being similar in all substantia respects to that followed in the *Union Pacific Case* (Compare Judgments and Decrees in Antitrust cases p. 217.)

The essential provisions of the plan may be sum marized as follows (Rec. 40–45):

(1) The Reading Company will assume the entir burden of the $96,524,000 general mortgage 4 pe cent bonds, which are the joint obligation of Readin Company and Reading Coal Company, and wil

agree to save the coal company and its property harmless therefrom.

(2) The Reading Company will agree to pay to Reading ~~Coal~~ Company $10,000,000 in cash or current assets, and $25,000,000 in 4 per cent mortgage bonds to mature on the same date as the general mortgage, the mortgage to contain provision for the issue thereunder of additional bonds for additions, betterments, etc.

(3) General releases of all claims and liabilities as between the Reading Company and Reading Coal Company, including the claim of approximately $70,000,000 carried on the books of Reading Company as an asset and on the books of Reading Coal Company as a liability, will be exchanged.

(4) The Reading Company will agree to obtain the release of the coal property from the lien of the general mortgage and discharge of the coal company from liability on the general mortgage bonds provided such release and discharge can be obtained by payment by the Reading Company to the bondholders of a premium not exceeding 10 per cent on the par value of the outstanding bonds.

(5) A committee to be formed in the interest of the bondholders will call for the deposit of bonds and will hold them until it has been ascertained whether a sufficient number has been or will be deposited, when such committee will either stamp the bonds as assenting to the plan and return them to the depositors or else issue in their stead Reading Company refunding and improvement bonds.

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(6) The Attorney General will ask for the release of the stock of Reading Coal Company from the lien of the general mortgage. Reading Coal Company will consolidate with one of its subsidiaries or else a new company will be organized to succeed to Reading Company's interest in the coal company, and in either event the consolidated company or the new company will issue 1,400,000 [2] shares of no par value stock.

(7) Assignable certificates of beneficial interest in such no par value stock will be sold to the stockholders of the Reading Company, preferred and common, share and share alike, for $5,600,000, or $2.00 for each half share of the Reading stock. Such certificates may be exchanged for shares of stock when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company.

(8) If and whenever the bondholders' committee shall declare the plan of exchange effective, the Reading Company will execute a refunding and improvement mortgage, which shall constitute a direct lien upon all railroads, railroad property, equipment, etc., and all deposited general mortgage bonds will be kept alive under said refunding and improvement mortgage until the general mortgage is released.

Modification thereof.—Soon after the plan was made public on February 14, 1921, it became apparent that it would be impossible to obtain the consent of a sufficient number of the bondholders to carry the plan into effect according to its terms.

[2] Being 1 share for every 2 half shares of outstanding Reading stock.

The bonds are largely held in Pennsylvania, many by trust companies, insurance companies, and fiduciaries. These holders appeared to regard the coal properties as the backbone of their security; and it was apparent that a 10 per cent premium, or even a larger one, would not induce them to relinquish their lien on the stock or properties of the coal company.

Oppositions to the plan, as it affected the general mortgage, were filed by the Central Union Trust Company, trustee (Rec. 150–152); the Penn Mutual Life Insurance Company, owning $1,000,000, par value, of bonds (Rec. 144); the Girard Avenue Title & Trust Company, owning $15,000, par value, of bonds (Rec. 145); and the Pennsylvania Company for Insurance on Lives and Granting Annuities, owning individually and as trustee, administrator, executor, or guardian, $2,041,000, par value, of bonds. (Rec. 146–147.) In addition, numerous other holders announced their intention not merely to refrain from depositing their bonds but to intervene in opposition to the plan.

It clearly was not practicable to refinance the $96,524,000 of 4 per cent general mortgage bonds, which would not mature for 75 years, in the 7 per cent and 8 per cent money market, which then prevailed. The Attorney General, therefore, was confronted with these alternatives:

(1) To insist upon the court ordering the release of the stock and properties of Reading Coal Company from the lien of the general mortgage without the

consent and over the protest of the trustee and the bondholders; or

(2) To assent to a modification of the plan which, while placing in different hands the stock control of Reading Company and Reading Coal Company and providing effective safeguards against future intercorporate relations, would leave the stock and properties of the latter pledged under the general mortgage.

The following considerations appeared to make the latter course the wiser as well as the more expedient:

(1) The attitude of the trustee and bondholders made it clear that the former course would meet with an opposition which certainly would have resulted in another appeal to this court with consequent delay in effecting a dissolution.

(2) The questions propounded by the District Court in its order dated April 12, 1921 (supra p. 9), appeared to indicate a feeling on the part of that court that the requirements of the mandate could be met by proper injunctive provisions without disturbing the general mortgage.[3]

(3) This court had handed down its decision in *United States* v. *Lehigh Valley Railroad Co. et al.* (254 U. S. 255), ordering the dissolution of the combination between the Lehigh Valley Railroad Company, the Lehigh Valley Coal Company, Coxe Brothers &

[3] The observation of the three circuit judges of the third circuit in *United States* v. *E. I. du Pont de Nemours & Co.*, 188 Fed. 127, 155, to the effect that in a dissolution proceeding under the antitrust act it is unnecessary to bring in mortgage or other creditors, doubtless would have been deemed controlling.

Company (Inc.), the Delaware, Susquehanna & Schuylkill Railroad Company, and the Lehigh Valley Coal Sales Company—

> with such provisions for the disposition of all shares of stock, bonds, or other evidences of indebtedness, and of all property of any character, of any one of said companies, owned or in any manner controlled by any other of them as may be necessary to establish their entire independence of and from each other.

The stock of Lehigh Valley Railroad Company's principal subsidiary—Lehigh Valley Coal Company—was pledged under the former's general consolidated mortgage of which the Girard Trust Company was trustee. This court dismissed absolutely the Government's bill as to the Girard Trust Company, from which it was inferred that this court did not deem it essential to an effective dissolution of the relations between the two companies that the stock of Lehigh Valley Coal Company should be released from the lien of the mortgage.

(4) Finally, and most important, the country at that time was in the midst of a serious financial and industrial depression accompanying the transition from the artificial stimulations of war to normal conditions of peace. The condition was regarded as critical. Grave apprehension was felt that if the Government should insist upon the disruption of the general mortgage public confidence in the restoration of prosperity might be adversely affected. It seemed the course of wisdom, therefore, to avoid the possi-

bility of contributing further to an already threatening situation if it could be done without sacrifice to the effectiveness of the dissolution. The Government was not averse to any necessary surgery, but it seemed wise not to amputate any more than was necessary to secure the great policy of the Sherman law. In this it followed the admonition of this court in the *Standard Oil* and *Tobacco cases* that innocent interests, as the present holders of the bonds in question were, should be spared unnecessary injury.

Accordingly, with the assent of the Attorney General, a modification of the plan was filed providing, in substance, as follows (Rec. 210–212):

(1) The Reading Company will agree with Reading Coal Company (*a*) that at or before maturity of the general mortgage bonds it will obtain the release of the coal company's property under said mortgage and (*b*) the discharge of the coal company from liability on such bonds.

(2) The Reading Company will transfer all its right, title, and interest in the stock of the coal company, including the present right to vote and receive dividends thereon, to a new company to be organized, and will agree to save the new corporation and said stock harmless under the general mortgage, and will further agree at or before the maturity of the general mortgage to obtain the release of the coal company's stock and the delivery thereof to the new corporation—all in consideration of the payment by the new corporation to Reading Company of the sum

of $5,600,000 and its agreement to issue its shares as provided.

(3) The new company will issue 1,400,000 shares of no par value stock, which will be sold to the stockholders of Reading Company, preferred and common, share and share alike, for $5,600,000, or $2 for each half share of Reading stock.

(4) The sale will be carried out in accordance with the precedent established by the *Union Pacific Case*, by issuing to Reading stockholders, with or without the intervention of a trustee, as may be provided for in the final decree, assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of Reading Company.

(5) There will be embodied in the final decree an injunction against the new corporation exercising its voting power on the stock of the coal company in such a way as to bring about any new relations between the coal company and Reading Company of the character complained of in the present suit, and all necessary steps will be taken to insure an independent board and management so that the independence of the coal company need not await the process of distributing the stock of the new company among persons not stockholders of Reading Company.

(6) The decree may provide that, if by reason of default on the general mortgage bonds the Central

Union Trust Company shall have the right to vote the stock of the Reading Coal Company, it shall exercise such right so as not to bring about unity of management between the coal company and Reading Company; and further, in the event that the trustee is at any time obliged to sell the stock or properties of the coal company, it shall dispose of the same separately from the properties of Reading Company and to different interests.

Disposition of the stock of the Central Railroad Company of New Jersey.

The Central Railroad Company occupies an advantageous position on New York Harbor and for that reason possesses a strategic value in addition to its earning value as a carrier. Because of this the Jersey Central would be a desirable acquisition for any noncompetitive connecting carrier and the Jersey Central stock doubtless could be disposed of to better advantage to such a purchaser than any other. Under the provisions of the transportation act of 1920 (ch. 91, 41 Stat. 456, 481–482) the Interstate Commerce Commission is authorized to formulate a plan for the consolidation of railroads without regard to the antitrust act. Because of this the District Court was of opinion that the Reading Company's interest in the Jersey Central could not now be sold at its reasonable value, since no other railroad could acquire such interest with any assurance that it would be allowed to retain it. (Rec. 284–286.)

Rather than subject the stock to the possible sacrifice of a forced sale to the detriment not only of Reading Company but also to the almost equal number of other shareholders of the Jersey Central, the court ordered that the actual sale of the stock be deferred in view of possible action by the commission, and that it be transferred to trustees who will vote the same so as to secure "entire independence of directors and management between Reading Company, as it shall be hereafter merged with Reading Railway Company, and the Central Railroad Company of New Jersey." The decree provides, however, that the trustees shall hold such stock subject to further order, and that "the court may on its own initiative, or upon motion of the United States or Reading Company, without waiting such action by the Interstate Commerce Commission, enter an order for the sale of such stock, if and when it shall appear that the facts require it, or the situation makes it possible." (Rec. 296.)

Dissociation of the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company.

The plan for the disposition by the Central Railroad Company of New Jersey of the stock of the Lehigh & Wilkes-Barre Coal Company provided simply that such stock should be sold to persons not stockholders of the Jersey Central, Reading Company, or Reading Coal Company, and who previous to or at the time of purchase shall qualify as purchasers by a duly executed affidavit to the

effect that they do not own stock in any of those companies. As before stated, this provision has been carried out, although there is pending in the District Court an application to set aside the sale.

SPECIFIC QUESTIONS CONSIDERED.

The court having notified counsel that upon the reargument it desired special attention to be given certain specific questions, such questions will be considered in order:

1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court.

No appeal was taken by the Government from the decree of the District Court because that decree seemed to Government counsel to provide an effectual dissolution of the unlawful combination as contemplated by the opinion of this court. As regards the dissociation of the Reading Company and the Philadelphia & Reading Coal & Iron Company the decree appeared to be adequate for the following reasons:

(1) The Reading Company will be completely divested of all its right, title, and interest in the stock of Reading Coal Company, including the right to vote such stock, the right to receive dividends thereon, and the right to receive the actual shares on discharge of the mortgage.

(2) All of Reading Company's interest in said stock will be transferred to a new company which, when the process of distribution has been completed, will have as stockholders persons who are not stockholders of Reading Company.[4]

(3) The distribution of the stock of the new company to the ultimate owners will be effected through the instrumentality of trustees appointed by the court and discharging their duties under its direction, who will exercise all voting rights and collect and retain all dividends until such stock is turned over to the duly qualified owners.

(4) The officers and directors of the new company in the first instance will be elected with the approval of the court; no officer or director of the new company may at any time be an officer or director of the Reading Company;[5] and the new company, before receiving Reading Company's interest in the coal company stock, will enter its appearance in the cause and submit itself to the jurisdiction of the court.

(5) During the three-year period allowed for the conversion of the certificates of beneficial interest for the stock of the new company no present stockholder of the Reading Company shall be a purchaser

[4] The method adopted is substantially the same as that employed in the Union Pacific-Southern Pacific dissolution. (Judgments and Decrees in Antitrust Cases, p. 217.) The advantages of this method over that employed in the Standard Oil and Tobacco cases are pointed out in the Annual Report of the Attorney General for 1913, pp. 7–8.

[5] It doubtless was the intention also to provide that no stockholder of the new company may be a director of the Reading Company and *vice versa*. Probably the control which the court will continue to exert over the new company and its stockholders will prevent this (*infra*, p. 28). If not the decree can doubtless be modified with the consent of all parties to provide against such a contingency.

of stock of the new company; and the Attorney General shall have access to the stock transfer books of both companies to enforce compliance with the order.

(6) Effective upon its becoming a party defendant the new company, its officers and directors, are enjoined and restrained from exercising the voting power on the coal company stock so as to form such a combination between the coal company and the Reading Company as was adjudged unlawful by this court.

(7) The Reading Company and all persons acting for or in its interest are perpetually enjoined from acquiring, receiving, holding, voting, or in any manner acting as the owner of any shares of the new company; and the new company and all persons acting for it are enjoined from acquiring, voting, etc., any of the shares of Reading Company.

(8) The coal company is permanently enjoined from issuing to the Reading Company, and the Reading Company is enjoined from receiving any stock, bonds, or other evidences of corporate indebtedness of the coal company in addition to the $25,000,000 of 4 per cent bonds provided for in the plan of dissolution.

It results, therefore, that all intercorporate relations between the Reading Company and the Reading Coal Company will be absolutely terminated except that (*a*) the capital stock and properties of the coal company will remain pledged as collateral security under the general mortgage; (*b*) there will be an

agreement between Reading Company and the Reading Coal Company whereby the former will undertake to save the latter harmless under the general mortgage, and (*c*) the Reading Company will own $25,000,000 of the second mortgage bonds of the coal company.

The agreement of Reading Company to assume the entire burden of the general mortgage will only be binding as between it and the coal company, so that the general mortgage bondholders will retain their grip on both properties. However, these bondholders are creditors and not owners of the debtor corporations, their bonds carry no voting rights, except in the event of a default, and they exercise no control over the corporate affairs. Their voting rights in the properties do not come into existence save on default, and present and prospective earnings of Reading Company would seem to make such default a remote contingency. However, even in case of default, the decree, following the plan, provides (*a*) that the trustee shall vote the coal company stock so as not to bring about a recurrence of the conditions condemned in this cause; and (*b*), if it shall be necessary to sell the properties, then the railroad and mining properties shall be sold separately and to different interests.

In addition, the decree provides for the close supervision of the dissolution proceedings by the court and the Attorney General. Under the principle announced in a recent decision of the United States District Court for Delaware, composed of the

three circuit judges of the third circuit, the jurisdiction of the court to enter orders for giving effect to the decree will continue indefinitely. (*United States* v. *E. I. du Pont de Nemours & Co.*, 273 Fed. 869.) That decision involved an application for a modification of the decree in the Powder Trust case by the Hercules Powder Company, one of the corporations organized pursuant to the decree to take over a portion of the assets and properties of the du Pont Company. The court held, in effect, that the Hercules Company, organized as stated, was an instrument of the court over which it would retain a continuing jurisdiction for the purpose of making all needful orders to carry out the objects of the decree. The rule would apply to the new corporation to be formed to take over the coal company stock, and it was to that decision that Judge Buffington had reference when he said (Rec. 283–284):

> In the creation of such a corporation by this court's order, we follow a general course pursued in the case of *United States* v. *du Pont et al.* (188 Fed. 127), and the wisdom of so doing will be seen by an examination of the opinion lately filed in that case, where the purpose of such procedure is fully explained. By the creation of this new corporation by the directions of this court and by its retention of jurisdiction to enforce this decree as therein provided, the court can, if such contingency should arise by its control of this newly formed corporation, control all of its stockholders and prevent such stock from ever being used to thwart the decree made in pursuance of the plan.

The $25,000,000 of second mortgage bonds will be considered briefly under the fourth question.

2. Whether the general mortgage having been executed and the bonds secured by it issued as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for the sale of the coal company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage.[6]

The existing general mortgage admittedly was an essential feature of the reorganization plan of 1896 (Rec. 213–251) which, this court has held, resulted in "a combination to unduly restrain interstate commerce within the meaning of the (anti-trust) act."

As shown by the plan (Rec. 221) the general mortgage bonds were designed for issuance mainly in exchange for outstanding mortgage securities of the Philadelphia & Reading Rail*road* Company and for new construction, improvements, and betterments—purposes not in themselves unlawful.

However, holders of these bonds may be presumed to have received them with knowledge of the scheme under which they were issued, and although they have had no voice in the management of the Reading Company it may possibly be said of them that they are *in pari delicto*, as was said of the different classes of stockholders of the Northern

[6] It is not understood that the stock of the coal company will be subject to the lien of the contemplated new mortgage.

in the property of another company from which it has been completely dissociated.

The payments, therefore, represent the estimated proportionate share of the coal company of the burden of the general mortgage. The property and assets of the coal company comprise approximately one-third of the assets of the two companies subject to the general mortgage. Crediting the second mortgage bonds at par, the total amount to be paid is somewhat in excess of one-third of the total amount of outstanding general mortgage; but the annual interest payments on the second mortgage bonds ($1,000,000) will amount approximately to one-fourth of the annual interest charge on the $96,524,000 of general mortgage bonds ($3,860,760).

While the payments bear this relation to the burden to be assumed by Reading Company under the general mortgage, the amount and character of the payments was determined upon by the directors of Reading Company based upon an estimate of the future needs and uses of the Consolidated Reading Company and the ability of the coal company to pay, the purpose being to provide for the future successful operation of both.

April 10, 1922.

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○

No. 609.

In the Supreme Court of the United States,

OCTOBER TERM, 1921.

CONTINENTAL INSURANCE COMPANY

AND

FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,
Appellants,

v.

READING COMPANY, *et al.*,
Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

SUPPLEMENTAL BRIEF FOR APPELLANTS ON REARGUMENT.

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CASES CITED.

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APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

SUPPLEMENTAL BRIEF FOR APPELLANTS ON REARGUMENT.

Introduction.

Conceiving themselves aggrieved by the final decree entered in the Court below, the appellants prosecuted this appeal and assigned as error the matters whereby the decree injuriously affected their interests as holders of common stock.

From the order of this Court setting the case for reargument, we understand the Court desires that argu-

ment be presented upon matters other than the immediate interests of these appellants as holders of common stock, and that special attention be given on the reargument to certain specified questions.

There can of course be no doubt as to the power of the Court in this case *sua sponte* to consider questions not raised by assignments of error. The appellants complain of a final decree entered upon the mandate of this Court. The power of the Court to exercise original jurisdiction to determine upon the application of an interested party whether its mandate has been observed in a decree, purporting to be entered pursuant thereto, is established. *United States* v. *St. Louis Terminal,* 236 U. S. 194, 199, 200. We take it that the appellants may therefore now raise questions not specifically assigned as error (*United States* v. *St. Louis Terminal, supra*) and that this Court *sua sponte* may inquire as to whether its mandate has been properly performed, for the interested parties are before the Court.

The question of whether or not the decree entered below, achieves the result sought by this Court in its enforcement of the Anti-Trust Act and the Commodities Clause of the Interstate Commerce Act, so far as the public interest is involved, is a matter of primary concern to parties before this Court other than these appellants. Regarding it as an obligation to the Court to respond to its request, counsel for these appellants will endeavor to answer the inquiries that have been propounded.

We have not had the opportunity nor the facilities exhaustively to examine the facts involved in some of the matters affecting the complete dissolution of the combination in restraint of trade sought by this Court through its mandate, but subject to correction to the extent that we may not be in full possession of the facts, we beg leave to submit to the Court, this supplemental brief.

The Issues upon the Reargument.

The reargument is directed

> "on the question whether the decree in the District Court * * * is in conformity with the opinion of this Court in *United States* v. *Reading Company*, 253 U. S. 26".

We do not understand that the order of the Court is intended to apply to questions affecting the shares of stock of the Lehigh & Wilkes-Barre Coal Company or those of the Jersey Central.

For convenience, we shall hereinafter refer to The Philadelphia & Reading Railway Company as the Railway Company, to the Philadelphia & Reading Coal and Iron Company as the Coal Company, to the Company which, under the plan, is to acquire all the right, title and interest of the Reading Company in the stock of the Coal Company as the New Coal Company, to the stock of such New Coal Company as the stock of the New Coal Company, and to the Railway Company, the Coal Company and the Reading Company collectively as the Reading Companies.

With respect to the Reading Companies, this Court in 253 U. S. 26, held that the combination between and the practices of such Companies constituted violation of Sections 1 and 2 of the Anti-Trust Act and the Commodities Clause of the Interstate Commerce Act, and in its opinion declared that the cause be remanded to the District Court

> "with directions to enter a decree in conformity with this opinion, dissolving the combination of the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company * * * existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held

> by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal & Iron Company * * * to the end that the affairs of all of these now combined companies may be conducted in harmony with law" (R. 25).

Manifestly the decision of this Court did not contemplate "safeguarding one public interest by destroying another" nor the removal of "one cause of illegality in a combination by substituting another". *United States* v. *St. Louis Terminal,* 236 U. S. 194, 205, 206. Nor did this Court intend that a final decree be entered which would be

> "repugnant to the provisions of the Act to Regulate Commerce and contrary to the exercise by the State authorities of their power * * * insofar as the jurisdiction of such authorities may have extended", (*Ibid.* 207).

And it seems clear that this Court did not intend that the final decree should confer upon any one class of stockholders of the Reading Company any benefit to the prejudice of the rights of any other class of stockholders.

The main issue upon this reargument, therefore, is whether the decree of the Court below effectively dissolves the combination held to be unlawful and whether compliance with its provisions, creates illegality in other directions or disposes of property to the prejudice of any class of stockholders.

Of the questions arising upon this main issue, this Court has directed counsel to give special attention to the following:

1. Whether the disposition by the Reading Company of the stock of the Philadelphia & Reading Coal & Iron Company, contemplated and ordered in the decree of the District Court, will establish

such entire independence between the Reading Company, present and prospective, and the Philadelphia & Reading Coal & Iron Company and the new company to be organized, as is required by the opinion and judgment of this court.

2. Whether the general mortgage having been executed, and the bonds secured by it issued, as a part of the process of forming the combination held to be unlawful, there is any legal or practical difficulty in providing, by appropriate modification of the decree, for sale of the Coal Company's stock, owned by the Reading Company, free from the lien of that mortgage, and from the lien of the contemplated new mortgage.

3. Whether compliance with the decree will confer on any one class of stockholders of the Reading Company any benefit, to the prejudice of the rights of any other class of stockholders.

4. What the basis is upon which the amount and character of the payments to be made by the Coal Company and by the new Company to the Reading Company was arrived at, and what the reasons are for adopting it.

It would also seem necessary to inquire

(*a*) Whether the retention by the Reading Company of the stock of the Reading Iron Company and the merger of the Railway Company with the Reading Company is in conformity with the opinion of this Court in *United States* v. *Reading Company,* 253 U. S. 26;

(*b*) Whether the retention by the Reading Company of the stock of the Reading Iron Company and the merger of the Railway Company with the Reading Company creates a violation of Article 17, Section 5, of the Constitution of Pennsylvania.

Position of these Appellants on the Foregoing Issues.

Upon the foregoing issues *seriatim,* the following is our position:

1. In our opinion, the disposition by the Reading Company of the stock of the Coal Company as decreed by the District Court will not establish such entire independence between the Reading Company and the New Coal Company as is required by the opinion of this Court.

2. We concede the power of this Court to direct the sale of the stock of the Coal Company free from the lien of the General Mortgage upon terms which shall be equitable to the holders of the bonds issued under the Mortgage; but we recognize there are practical difficulties in the way of accomplishing such result.

3. Upon the grounds set forth in our main and reply briefs we contend that compliance with the decree of the District Court will confer great benefit upon the holders of preferred stock of the Reading Company to the prejudice of the rights of holders of its common stock.

We will supplement our previous briefs on this question with the consideration of some matters urged upon the oral argument in this Court.

4. Appellants had no opportunity to participate in determining what the basis is upon which the amount and character of payments to be made by the Coal Company and by the New Coal Company to the Reading Company was arrived at, and have had no clear statement of the basis. We believe the basis was arrived at by the Board of Directors of the Reading Company, which Board was and is controlled by the New York Central and Baltimore & Ohio Railroad Companies. The grounds urged in support of the basis are without merit.

5. From the facts which we have been able to gather, we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company will create a violation of the Commodities Clause.

6. From the facts which we have been able to gather we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company creates a violation of Article 17, Section 5, of the Constitution of Pennsylvania which provides:

> "No incorporated company, doing the business of a common carrier shall, directly or indirectly, prosecute or engage in mining or manufacturing articles for transportation over its works; nor shall such company directly or indirectly, engage in any other business than that of common carriers, or hold or acquire lands, freehold or leasehold, directly or indirectly, except such as shall be necessary for carrying on its business; but any mining or manufacturing company may carry the products of its mines and manufactories on its railroad or canal not exceeding fifty miles in length."

I.

The disposition by the Reading Company of the stock of the Coal Company as decreed by the District Court will not establish such entire independence between the Reading Company and the Coal Company as is required by the opinion and judgment of this Court.

The Coal Company has issued and outstanding $8,000,000 par value of capital stock. The Reading Company owns all of the capital stock of the Coal Company and pledged that stock as part of the collateral to secure the joint General Mortgage of the Reading Company and the Coal Company as a part of the reorganization of the

Reading Company in 1895 (R. 7). The stock of the Coal Company is now physically in the possession of the Central Union Trust Company as Trustee under the joint General Mortgage (R. 291). There are now issued and outstanding under the General Mortgage approximately $96,000,000 principal amount of bonds. The bonds mature in 1997.

Paragraph 5 of the Plan provides (R. 275, 276):

> "The Reading Company will, subject to the lien of the General Mortgage sell, assign and transfer all its right, title and interest in and to the stock of the Coal Company * * * to a new corporation to be formed with appropriate powers * * * The new corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the new corporation to the stockholders of the Reading Company, preferred and common, share and share alike for $5,600,000 or $2.00 for each share of Reading stock * * * It is proposed to carry out this sale in accordance with the precedent established by the Union Pacific—Southern Pacific case, by issuing to Reading stockholders, * * * assignable certificates of interest in the stock of the new corporation exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company."

This is in substance the plan for the disposition of the stock of the Coal Company, notwithstanding certain variations as to detail appearing in the decree.* Cer-

* The plan provides that the new corporation is to issue 1,400,000 shares of stock and that "such no par value stock will be sold by the new corporation to the stockholders of the Reading Company" (R. 275). The decree provides:

> The stock of the new corporation shall be issued to a trustee or trustees appointed by the Court. Such trustee or trustees shall issue certificates of interest therein as contemplated by the modified plan and as hereinafter provided. The *Reading Company shall offer* such certificates of interest *for subscription* to its stockholders" * * * (R. 292) (Italics ours).

tificates of interest in stock of a new company (the New Coal Company) which is to acquire the stock of the Coal Company subject to the General Mortgage will be "sold" to stockholders of the Reading Company.

Paragraph 3 (*f*) of the decree (R. 293, 294) provides for the affidavit to be executed by a holder of such a certificate of interest in order to obtain stock in the New Coal Company.

In aid of the establishment of the independence of the Coal Company from the Reading Company the decree in paragraph 3 (*i*) thereof provides (R. 295):

> "During the period allowed for the conversion of the certificates of interest into stock of the new corporation, no present stockholder of the Reading Company shall be a purchaser of stock of the new corporation if still a stockholder of the Reading Company; and the Attorney-General of the United States shall have access to the stock transfer books of the Reading Company and the new corporation for the purpose of enabling him to enforce compliance by such stockholders with this provision of this decree; but nothing herein contained shall extend to holdings as broker, pledgee, trustee, agent or otherwise in a representative capacity."

When all of these steps have been taken the following will be the situation of the Coal Company and its stock:

Title to the coal properties will remain in the present Coal Company. These properties are subject to the joint General Mortgage of the Reading Company and the Coal Company and no determination has been made as to the liability of each of the companies with respect to such joint General Mortgage. The $8,000,000 of capital stock of the Coal Company will remain pledged under the joint General Mortgage and the stock will presumably stand in the name of the Central Union Trust Company as Trustee thereunder. The New Coal Company will hold the equity

of redemption in such stock. As a holder of such equity of redemption the New Coal Company will receive from the Central Union Trust Company irrevocable proxies to vote the stock of the Coal Company (R. 291) and the New Coal Company will also be entitled to receive the dividends payable upon the stock of the Coal Company (for under the terms of the joint General Mortgage the holder of the equity of redemption in the stock of the Coal Company will be entitled to all income therefrom). The stock of the New Coal Company will be held by trustees and against such stock the trustees will issue certificates of interest to the stockholders of Reading Company and a holder of such certificate may exchange it for the stock represented thereby upon making the required affidavit. Ultimately, if the plan is consummated, the stock of the New Coal Company will be held by individuals, who, it must be assumed, should be persons other than those connected with the Reading Company when merged with the Railway Company (*United States* v. *Union Pacific*, 226 U. S. 470).

We do not regard the provisions of the plan, aided though they are by the provisions of the decree of the Court below, sufficient to establish entire independence between the Reading Company and the Coal Company.

There is nothing in the decree which will prevent a holder of stock of the Reading Company from disposing of his holdings in the Reading Company, then making the required affidavit and obtaining the stock of the Coal Company and thereafter immediately acquiring stock in the Reading Company.

In our petition of intervention (R. 72) we suggested that the Court

> "require the Reading Company to adopt a by-law that it will register no transfers of shares of stock of the Reading Company into the names of persons who shall not make affidavit that they have not for

> such period as the Court shall direct, been holders of proxies* to vote shares of stock of the Coal Company."

And in reply to the question propounded by the District Court (R. 206)

> "Whether the sale provided for in pargraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful,"

we said that the proposed plan, unless modified in the manner suggested by the language just quoted, is not such a disposition of the stock of the Coal Company as constitutes a compliance with the mandate of this Court. There is no hardship upon the general investing public in preventing one from holding stock in both the Reading Company and in the Coal Company. There are sufficient opportunities for lawful investment and the restriction will work no harm to any one who is satisfied to be guided by the public policy enunciated by this Court.

It was contended in the District Court and will no doubt be contended here that the instant case is governed by the decree adopted by the District Court in the *Union Pacific* case. But the decree of the lower court in the *Union Pacific* case was never passed upon in this Court, and even if it had been, it would furnish no precedent for this case.

In *United States* v. *Union Pac. R. R. Co.*, 226 U. S. 470, this Court was asked to approve the dissolution of

* The Plan now provides for the right to vote the stock of the Coal Company to be vested in the New Coal Company and therefore no proxies are to be issued. The stock of this New Coal Company is the equivalent of the proxy.

the combination of the Union Pacific and the Southern Pacific, theretofore declared to be unlawful, through a sale of the stock of the Southern Pacific to the stockholders of the Union Pacific. Similar methods had been adopted in the *Northern Securities* and in the *Standard Oil Company* cases. In disapproving of the proposal submitted in the *Union Pacific* case, this Court, MR. JUSTICE DAY writing, said what is precisely pertinent here (*ibid.* 474)

> "each case under the Sherman Act must stand upon its own facts, and we are unable to regard the decrees in the *Northern Securities Case* and the *Standard Oil Company Case* as precedents to be followed now, in view of the different situation presented for consideration."

We submit this case is as different from the *Union Pacific Case* as the *Union Pacific Case* was from the *Northern Securities Case* and the *Standard Oil Company Case.*

In the *Union Pacific Case* the Union Pacific controlled only 46% of the total outstanding stock of the Southern Pacific. In this case the Reading Company controls all of the outstanding stock of the Coal Company. Safeguards which would be applicable in the *Union Pacific Case* are not sufficient here.

In the *Union Pacific Case* the fact that 68 stockholders held $139,000,000 of stock and 300 others an additional $59,000,000 of stock, the two groups together owning 62.8% of a total issued and outstanding stock of $316,000,000, was conceived by this Court to distinguish the case from the *Northern Securities Case* and the *Standard Oil Company Case.*

In this case two stockholders alone, The New York Central and the Baltimore & Ohio own and control approximately 43% of the total issued and outstanding

stock of $140,000,000 of the Reading Company.* Another stockholder owns, represents or controls 101,900 shares of stock of the Reading Company.† The financial journals report the fact that he has recently been elected to the Board of Directors of the Baltimore & Ohio. These these three stockholders therefore together own or control 46.8% of the total issued and outstanding stock of the Reading Company.

In the *Union Pacific Case* the 368 stockholders who owned collectively 62.8% of the outstanding stock of the Union Pacific received certificates with respect to 20.15%‡

	No. of Shares	Par Value
*The New York Central Railroad Company owns (R. 140)		
First Preferred	121,300	$6,065,000
Second Preferred	285,300	14,265,000
Common	197,050	9,852,500
Total	603,650	$30,182,500
The Baltimore & Ohio Railroad Company owns (R. 142)		
First Preferred	121,300	$6,065,000
Second Preferred	285,300	14,265,000
Common	200,050	10,002,500
Total	606,650	$30,332,500

Together the two Railroad Companies own 1,210,300 shares of the par value of $60,515,000, or 43.22% of the total issued and outstanding stock of the Reading Company.

† Joseph E. Widener is the owner of 1,900 shares of common stock and represents 6,700 shares of common stock standing in the name of P. A. B. Widener and 93,300 shares of common stock standing in the name of the Estate of P. A. B. Widener (R. 209).

‡ The Union Pacific owned $126,650,000 par amount of the stock of the Southern Pacific Company or about 46% of the outstanding stock of the Southern Pacific. The decree entered by the Court approved the sale of $38,292,400 par value of the Southern Pacific stock or 13.90% of the total issued and outstanding stock of the Southern Pacific, to the Pennsylvania Railroad Company in exchange for certain shares of stock of the Baltimore & Ohio Railroad held by the Pennsylvania Railroad Company, and directed that certificates of interest in the remaining $88,357,600 par value stock of the Southern Pacific Company, or 32.10% of the total issued and outstanding stock of the Southern Pacific to be sold to the stockholders of the Union Pacific. Hence, the holders of 62.8% of stock of the Union Pacific received certificates of interest in only 20.15% (62.8% of 32.10%) of the stock of the Southern Pacific.

of the outstanding stock of the Southern Pacific. But in this case two stockholders alone will receive certificates of interest representing 43% of the stock of the Coal Company, and they will be in a position through the sale or other disposition of their certificates of interest *to transfer control of the Coal Company.*

The *Union Pacific Case* involved a violation of the Anti-Trust Act only. In this case, the union of the companies constitutes in addition to a violation of the Anti-Trust Act, a violation of the Commodities Clause. The attraction of the Coal Company to the Reading Company has been much greater than was the attraction of the Southern Pacific to the Union Pacific.

It must be admitted that a situation where two large stockholders of the Reading Company holding 43% of its shares will also hold a 43% interest in the stock of the New Coal Company presents a question of no little concern.

A few of the possibilities need merely be suggested. Notwithstanding the terms of paragraphs (*j*) and (*k*) of the decree (R. 295) it may well be that, until a lawsuit proves the contrary, the New York Central and Baltimore & Ohio may transfer their holdings in the Reading Company to new corporations and distribute the stock of those companies among their own stockholders, and they may then acquire the stock of the New Coal Company. Or, when organizing this new corporation they may place the stock in a voting trust and distribute voting trust certificates to their own stockholders. Or, they may decide to retain their holdings in the Reading Company, and dispose of the certificates of interest in the stock of the Coal Company to a new corporation and distribute the stock of that corporation among their own stockholders. That new corporation may then obtain the stock of the Coal Company. Effective dissolution of the conbination should not be dependent upon such contingencies, the illegality of which could at earliest be deter-

mined after litigation. General injunctive provisions, at best, would seem of little more effect than the criminal provisions of the Anti-Trust Act itself.

The New York Central and the Baltimore & Ohio may not *exercise* control over both the Reading Company and the Coal Company. But they may *transfer* control over both Companies, provided the transfer of their interest in the Coal Company precedes that in the Reading Company.

Surely the *Union Pacific Case,* if it is a precedent at all, cannot be invoked here. The situation is so pregnant with possibilities that we submit future litigation will be avoided by a sale of the stock of the New Coal Company outright to independent purchasers (not stockholders of the Reading Company), under such conditions as will assure the Court that they are in fact independent, with an equal opportunity to all to submit bids for the stock upon information given freely and fairly to all prospective bidders covering the nature, the character, the extent and the value of the properties of the Coal Company.

II.

This Court is vested with plenary power to separate the coal properties from the railway properties. Wherever the General Mortgage is an obstacle to the achievement of entire independence of the Coal Company from the Reading Company or the Railway Company, this Court has power upon terms which are equitable and reasonable to compel modification of the General Mortgage. Practical difficulties, however, exist in determining and carrying out terms which are equitable and reasonable.

The joint General Mortgage of the Reading Company and the Coal Company was executed with an eye to the establishment and maintenance of common control over the Coal Company and the Railway Company. The

shares of stock of the Coal Company and the Railway Company were pledged to secure the General Mortgage. The mortgage provides (Article 2, Section 9):

> "Except subject to the lien hereof or as herein otherwise expressly provided, the Companies (1) will not sell, encumber or by any voluntary act part with their respective ownership of and title to any shares of stock of any company above enumerated in I and II of Subdivision Fifth of the granting clauses hereof, or to any shares of stock of any company which shall hereafter be pledged hereunder (if a majority of the shares of such company shall have been, or shall be, so pledged), or the equity of redemption therein or the voting power thereof;"

Among the shares of stock enumerated in I and II of Subdivision Fifth of the granting clauses of the Mortgage are,

> The Philadelphia & Reading Railway Company 399,900 shares, par value $19,995,000;
> Philadelphia & Reading Coal & Iron Company, 159,900 shares par value $7,995,000.

Article Six of the General Mortgage provides:

> "Upon the written request of the Companies * * * but subject to the conditions and limitations in this Section prescribed, and not otherwise, the Trustee, in its discretion, may release from the lien and operation of this indenture any part of the mortgaged and pledged premises, excepting * * * (2) the shares of stock mentioned under I and II of Subdivision Fifth of said granting clauses. * * *"

Under this provision the Trustee is not authorized to release the shares of stock of the Coal Company or of the Railway Company from the General Mortgage, although it may release the properties of the Coal Company which are subject to the General Mortgage.

By the provisions of Section 4 of Article Four of the General Mortgage, the Trustee is authorized to sell all

of the property subject to it, in two separate lots, the first lot to be sold as an entirety to be composed of all of the property conveyed by the Reading Company to the Trustee under the General Mortgage. This includes the stock of the Railway Company and of the Coal Company.

By Section 6 of Article Four it is provided that in the event of any sale, whether made under the power of sale granted by the General Mortgage or by virtue of judicial proceedings or of some judgment or decree of foreclosure and sale, the whole of the property should be sold as provided in Section 4 of Article Four in two separate lots, unless the holders of a majority of the bonds shall request a sale to be made in some other manner.

This Court has held that the common domination and control of the Railway Company and the Coal Company is a violation of the Anti-Trust Act and of the Commodities Clause. The Court below recognized the power vested in it to limit the provisions of the General Mortgage in such manner as would tend to prevent such domination and control.

Paragraph 6 of the decree provides (R. 298):

> "If by reason of default on the General Mortgage bonds Central Union Trust Company of New York, the Trustee under the General Mortgage, shall exercise the right to vote the stock of the Coal Company, it shall so exercise that right as not to bring about unity of management between the Coal Company and the Reading Company; and in the event that said Trustee at any time is obliged to sell the stock or properties of the Coal Company, it shall dispose of such stock and properties separately from the properties of the Reading Company and to different interests."

No objection to this provision was made below either by the holders of bonds under the General Mortgage or the Trustee thereunder.

If, in the opinion of this Court, the entire independence of the Coal Company from the Railway Company cannot be achieved without a release of the stock of the Coal Company from the General Mortgage, we deem the Court vested with power to compel the release of the stock of the Coal Company from the General Mortgage upon terms which are equitable. The power of this Court is plenary for such purpose. All agreements in the General Mortgage providing to the contrary must yield to the Anti-Trust Act which was in force and effect when the General Mortgage was executed, and must be deemed subordinate to the power of this Court to enforce the provisions of that Act.

The exercise of such power by this Court does not involve a determination of the question whether the General Mortgage was or was not invalid because it was a part of the process of creating the combination adjudged unlawful. The questions involved in *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540; *Wilder Mfg. Co.* v. *Corn Products Co.*, 236 U. S. 165; *Chicago Wall Paper Mills* v. *General Paper Co.*, 147 Fed. 491; *Continental Wall Paper Co.* v. *Voight*, 212 U. S. 227, are not presented here. We assume the pledge was valid and that all of the provisions of the General Mortgage are valid, except insofar as they infringe upon the Anti-Trust Act, and every such infringing provision must yield to the power of this Court adequately to enforce such Act.

Our view derives support from the decision of the District Court for the Southern District of Ohio (WARRINGTON, KNAPPEN and DENISON, Circuit Judges) made in the process of dissolving the combination of railway and coal companies adjudged a violation of the Anti-Trust Act in *United States* v. *Lake Shore & M. S. Railway*, 203 Fed. 295. The decision is not reported, but the case resembles the case at bar so much and the reasoning of the Court appears to us so persuasive, that we think it helpful to examine the situation there pre-

sented, in order that what was there decided may clearly appear.

In order to dissolve the unlawful combination the Court directed generally that the coal companies and the railroad companies should be separated from one another (203 Fed. 295, 319). The Hocking Valley Railway Company was one of the defendants in the case. It had been created and had acquired title to various railroad properties, in 1899, pursuant to a plan for the reorganization of the Columbus, Hocking Valley and Toledo Railroad Company (203 Fed. 301). As a part of that plan of reorganization of 1899 the Buckeye Coal & Railway Co. (hereinafter called the Buckeye Coal Company) was incorporated for the purpose of acquiring the coal properties of the Hocking Coal & Railroad Company and these properties were conveyed to the Buckeye Coal Company in consideration of the delivery to the purchasing trustees at the judicial sale of 2,495 shares of its total capital stock of 2,500 shares (*Ibid.* 302). The purchasing trustees thereupon transferred the stock of the Buckeye Coal Company to the Hocking Valley (*Ibid.* 303). The combination adjudged unlawful originated in the reorganization of 1899.

The Hocking Valley and the Buckeye Coal Company then joined in the execution of a mortgage, dated March 1, 1899 (hereinafter called the Consolidated Mortgage), providing for the issue of first mortgage bonds in the sum of $20,000,000 and secured by the properties acquired by such Companies (*Ibid.* 303). The Hocking Valley pledged the stock of the Buckeye Coal Company with the Central Trust Company, the Trustee under the Consolidated Mortgage for the further security of the Consolidated Mortgage. Out of the proceeds of the First Mortgage Bonds, the Hocking Valley acquired also the stock and properties of the Ohio Land & Railway Company, a coal company (hereinafter called Ohio Land Company), and it pledged this stock, as also the bonds of the Ohio Land Company with the Central Trust Company

under the Consolidated Mortgage.* At the time when the question arose there were issued and outstanding under the Consolidated Mortgage approximately $16,044,000 principal amount of Consolidated Mortgage Bonds.

On October 9, 1915, the United States filed in the dissolution suit a petition seeking to enforce the sale of the interest of the Hocking Valley in the stock of the Buckeye Coal Company and the Ohio Land Company in furtherance of the decree of the Court which required the separation of the coal companies from the railway companies.

The Central Trust Company as Trustee under the Consolidated Mortgage dated March 1, 1899, had been made a party to the suit, and it appeared, filed answer and resisted the sale of the stock of the Buckeye Coal Company and the Ohio Land Company free and clear from the lien of the Consolidated Mortgage. The Court, however, directed the sale of the stock of the Buckeye Coal Company and the Ohio Land Company, as also the bonds of the latter Company, *and directed the Central Trust Company to release all claim upon such shares of stock and bonds upon the receipt or tender of the proceeds derived from the sale of such stocks and bonds respectively.* It further provided that in every instance the proceeds of sale should be received and applied by the Trustee under and according to the terms of the Consolidated Mortgage. The memorandum opinion on the right of the Court to order such a sale free from the lien of

* What the Hocking Valley did with the stock of the Buckeye Coal Company and of the Ohio Land Company does not appear from the report of *U. S.* v. *Lake Shore & M. S. Ry. Co.*, 203 Fed. 295. The facts, however, appear in a decision (unreported) of the Court filed in a subsequent proceeding in that case wherein the Sunday Creek Coal Company filed a petition in the nature of an intervention in the original suit, in which it asked for relief against the Hocking Valley Railway Company with respect to the stock of the Buckeye Coal Company and of the Ohio Land Company as also the bonds of the latter company. The decision on this question is printed as Appendix A to this brief.

the Consolidated Mortgage appears to us conclusive and we set it forth in full. The Court said (unreported):

"(3) We cannot think the insistence of the Central Trust Company well founded that it is not amenable to judicial process or order requiring the company to exercise its powers to cause release to be made of the stocks and bonds in question under conditions such as those above stated, for it seems to be conceded that it is vested with power so to act on the pledgor's request, and whatever discretion it may have in such instances is certainly not one of an unreasonable or arbitrary character. * * * We regard as clear the power of the court to compel the bonds and stocks to be sold free from the lien of the consolidated mortgage, substituting therefor in the hands of the mortgage trustee the proceeds of such sale. One who takes a mortgage upon several items of property of such character that their common ownership or operation may offend against the anti-trust law or the commodities clause, and such that the mortgage serves practically to aid in tying them together, must be deemed to hold his mortgage subject to the contingency that if the complete and final separation of one item of the mortgaged property from the remainder becomes essential to the due enforcement of either named law, the court charged with such enforcement may take control of that item, free it from the consolidating tendency of the mortgage, and substitute therefor its judicially ascertained equivalent. Otherwise the mortgage will stand as the ready means of restoring—or at least tending to restore—those conditions which the court is endeavoring to destroy. It may well be true that a railroad and a coal company under common ownership and management, are worth more as security under a mortgage than when independent, and that their effective separation does impair the mortgage security, but this cannot make the law helpless.

If the power exists to direct a sale free from lien, the conditions here found make appropriate the exercise of that power. The consolidated mortgage was given by a railroad and a coal company; it challenged

attention to those features which carried potential violation of laws already passed or which might be passed; and the value of these pledged stocks and bonds, having nothing except lands to give them value, can be determined with such substantial accuracy that there is little danger of a mistake seriously prejudicial to the mortgage. We would have no confidence that a sale of the mere equity of the Hocking in these stocks and bonds would bring more than temporary independence. The purchaser could not free them from the overwhelming mortgage nor compel its foreclosure, but the danger of foreclosure and the consequent wiping out of this equity would be constant. The influence if not the practical domination, of the railroad mortgagor upon whom the purchaser must rely to prevent foreclosure, could not be escaped."

In providing in the instant case however, for the release of the stock of the Coal Company from the General Mortgage, practical difficulties will necessarily arise. The mortgagee is entitled to his security and it may not be taken from him except on terms which are equitable. If the General Mortgage allocated some value to the stock of the Coal Company we would not apprehend any great difficulty in providing for the release of the stock and for the deposit in cash subject to the terms of the General Mortgage of a sum equal to the value of the security released. The General Mortgage, however, allocates no such value.

Article Six of the General Mortgage makes provision for the use of the proceeds of property released therefrom. It provides that such sums may be employed either

"(1) to the purchase of bonds hereby secured in the same manner as is provided in Section 12 of Article Two hereof; or (2), with the approval of the Trustee, to the purchase of other property, real or personal, which shall be conveyed in trust by the Companies to the Trustee, subject to all the trusts hereby declared. Any new property acquired by the

Companies to take the place of any property released hereunder, *ipso facto,* shall become and be subject to the lien of this indenture, as fully as if hereby specifically mortgaged, but, if requested by the Trustee, the Companies severally and respectively will convey the same to the Trustee by appropriate deeds upon the trusts and for the purposes of this indenture."

The provisions of Section 12 of Article Two just referred to, are that the Trustee may employ such funds in purchasing bonds secured by the General Mortgage in such manner as to it shall seem best and at such prices as it shall deem best but not exceeding par and accrued interest. It further provides:

"To the extent that in the opinion of the Trustee bonds hereby secured cannot be bought on the terms herein prescribed, such bonds hereby secured may be purchased in the discretion of the Trustee and with the approval of the Reading Company at higher prices than those above fixed, or such unapplied balance shall be invested in securities in which Savings Banks at such time shall be authorized under the laws of New York to invest their funds, such securities to be held by the Trustee as a part of the trust estate hereunder; and the Trustee is hereby authorized from time to time in its discretion and with the consent of the Reading Company to dispose of any such securities purchased by the Trustee, and to reinvest the proceeds of such sale in similar manner, or to apply the same to the purchase and cancellation as aforesaid of bonds hereby secured.

All bonds hereby secured, when so purchased by the Trustee, shall be cancelled."

We therefore may be permitted to suggest various dispositions which we trust may be regarded as equitable to the holders of bonds issued under the General Mortgage:

(1) The stock of the Coal Company shall be sold free and clear of the General Mortgage, and the proceeds of

sale shall be deposited under the General Mortgage and subjected to the provisions of Article Six thereof with respect to the proceeds of released property. This will enable the proceeds to be employed by the Railroad Company for improvements on its property and private as well as the public interest will be benefited by the investment of such funds in additional railroad property which will thus become subject to the lien of the General Mortgage. This will practically enable the Railroad Company to obtain funds by paying interest at the rate of 4% per annum, whereas it would be compelled to pay higher rates of interest if it undertook any financing at this time. Or, to the extent that the needs of the Railroad Company do not exhaust the proceeds of sale, General Mortgage bonds may be purchased in the open market and cancelled. The bonds can now be purchased at or about 85 and the decree should contain such provisions as would enable the purchase of such bonds in the open market without duly enhancing the market price.

(2) This Court may compel the release of the Coal Company and its properties from all liability under the General Mortgage upon payment to the Trustee of $10,000,000 in cash or current assets and the execution and delivery by the Coal Company of $25,000,000 4% General Mortgage bonds to be secured by an appropriate mortgage. The Court may also compel the release of the stock of the Coal Company from the General Mortgage, and the sale of such stock in the manner suggested in (1).

(3) This Court may permit the payment by the Coal Company to the Reading Company of $10,000,000 in cash or current assets and the delivery by the Coal Com-

pany to the Reading Company of $25,000,000 new 4% Mortgage Bonds. The mortgage to secure such bonds, however, should under appropriate supervision by the Court, contain no provisions which will permit of the exercise of control by the Reading Company over the affairs of the Coal Company.* This Court may then compel the sale of the stock of the Coal Company free and clear of the General Mortgage in the manner suggested in (1).

(4) This Court may compel the release of the Coal Company and its properties from all liability under the General Mortgage and the sale of the stock of the Coal Company free and clear of the General Mortgage upon deposit with the Trustee under the General Mortgage of the proceeds of sale which shall be subject to the provisions of Article Six thereof with respect to the proceeds of released property.

In connection with any of the foregoing suggestions, this Court would undoubtedly make such provisions as it found necessary to secure the independence of the Coal Company from the Railway Company and the Reading Company, including the limitations suggested in I.

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* It may be noted that the plan does not now adequately provide against agreements in such mortgage to prevent the exercise in the future of control over the Coal Company by the Reading Company. The plan provides:

> "The mortgage under which they are to be issued may contain provision for the issue thereunder of additional bonds to provide for additions, betterments and improvements to a limited amount, *to be determined by the Reading Company and the Coal Company* prior to the creation of the mortgage, and shall contain provision for a proper sinking fund for the retirement of bonds issued thereunder."

III.

Compliance with the decree of the District Court will confer upon the holders of preferred stock great benefit to the prejudice of the rights of the holders of common stock.

In support of this contention we rely upon the matters set forth in our main and reply briefs. The oral argument merely strengthens the conviction that compliance with the decree of the District Court will work unwarranted injury to the rights of the common stock. If there were a *real* sale of the stock of the Coal Company for a *proper* consideration the common stock would not be prejudiced, even though a reduction in the surplus of the Reading Company might be involved.

The oral argument of appellees confirmed our contention that no sale is intended. The form of the sale is supported on the ground, among others, that it tends to work out a dissolution or liquidation. It is difficult however to appreciate why stockholders should be called upon to pay *any* consideration for their corporate property when distributed to them upon dissolution.

Supplementing our main and reply briefs we desire to refer to some of the suggestions made in oral argument by the appellees.

1. As to the right to redeem the preferred stock at par.

For the first time in these proceedings and for the first time in the history of the Reading Company, so far as we are advised, a doubt was sought to be cast on the oral argument upon the right of the Reading Company to redeem its preferred stock. The right to redeem the preferred stock, in our opinion, and as heretofore contended by us, has a bearing upon the dividend rights and the

rights upon dissolution of both the preferred and the common stock and limits the preferred stock to a realization of an amount no greater than its par value.

The following colloquy took place on the oral argument (Steno. Min. p. 84):

> "MR. JUSTICE CLARKE: What do you say as to the right to redeem the preferred stock?
>
> Mr. White: I think that has no bearing upon the question. In the first place, it is a mere option. I will read that clause; it is a rather peculiar one; I am reading from page 26 of my brief.
>
> 'The Reading Company shall have the right at any time to redeem either or both classes of its preferred stock, at par in cash, if such redemption shall then be allowed by law.'
>
> Nobody knows exactly why they put that in in that way; but presumably because at the time the stock was issued there was no statute of Pennsylvania which authorized this Company, or any similar company, to redeem its preferred stock.
>
> There has been no statute since which applies to the Reading Company. There is a serious question whether it could redeem the stock, if it tried to do so."

No cloud should be permitted to be thrown upon the right of the Reading Company and of the common stock to *redeem* the preferred stock under the powers conferred in the resolutions authorizing the issuance of the preferred stock and by the provisions of the stock certificates. The right to redeem, unquestioned for a period of more than 25 years, created by the provisions of the reorganization agreement and the resolutions authorizing the preferred stock and the stock certificates, is one of the basic rights of the Reading Company and of the common stock, and we therefore submit what we think establishes that which hitherto had been supposed to be the unquestioned validity of the right to redeem the preferred stock.

a. *The right to redeem exists but an unlawful exercise thereof is prohibited.*

Counsel for Kurtz appears to base his contention upon the language "if such redemption shall then be allowed by law". He would appear to contend that the proper interpretation of that language is that the right to redeem shall not exist unless there shall have been adopted a statute in Pennsylvania, applicable to the Reading Company, with respect to such redemption. Even as thus stated in its extreme form, the argument is without merit, because as we shall show there is in Pennsylvania at this time a statute, entirely applicable to the Reading Company, which provides for the redemption of preferred stock.

But in our view, the language "if such redemption shall then be allowed by law" did not refer to any statutory authorization of the right to redeem. It was intended solely for the purpose of placing limitations upon the right to redeem so that it might not be exercised to the prejudice of stockholders or creditors of the Reading Company. It was inserted through commendable foresight exercised by the counsel who prepared the stock certificates and the resolutions creating the stock. The language is apt for that purpose. It is "allowed", not "authorized". It is allowed "by law," not "by statute". Statutes contain but a part of the law. Action is allowed by law when it is lawful either under the common law, the decisions of the courts or legislative enactments and the decisions of the courts construing them.

We need but examine the state of the law in 1896 on the question of the redemption of stock by a corporation to gather that that language was inserted in the stock certificate and in the resolution creating the preferred and common stock of the Reading Company to prevent an unlawful exercise of the right to redeem.

The purpose underlying its insertion was the same as that which prompted the Legislature of Pennsylvania

when by Act of April 28, 1873 (P. L. 1873, p. 79), it authorized corporations organized under general law to redeem preferred stock, to limit the exercise of such right by the proviso:

> "that no injustice shall thereby be done to the existing rights of other stockholders or creditors of the company." *

b. *The Reading Company has the right to repurchase its own stock subject to limitations.*

To redeem preferred stock is to purchase the stock back. In *Mannington* v. *Hocking Valley Ry. Co.*, 183 Fed. 133, where the right to redeem preferred stock was in question, the court said:

> "'To redeem', it is said in *Miller* v. *Ratterman, supra* (47 Ohio St., 141, 24 N. E. 496), 'is to purchase back; to regain as mortgaged property by paying what is due; to receive back by paying the obligation.'"

What then, was the power of a Pennsylvania corporation to purchase its own stock in 1896? The answer to this inquiry furnishes the key to the purport of the language "if such redemption shall then be allowed by law".

The power of a corporation to purchase its own stock has developed gradually until it is now generally recognized, but it is subject to the limitation that the power may not be exercised when it injures either the stockholders or creditors of a corporation.

In *Commissioners* v. *Thayer*, 4 Otto 631, 24 L. Ed. 133, this Court said:

> "Unless prohibited by law, an incorporation may become the holder of a portion of its own shares". *Bank* v. *Bruce*, 17 N. Y. 507".

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* The statute is set forth in full, *infra*, p. 39.

In England, it is held that a corporation cannot pur chase shares of its own stock unless it is by its charte expressly authorized so to do, whether the purpose be t reissue or to retire the shares. *Trevor* v. *Whitworth*, 1 App. Cas. 409; *In re London, H. & C. Exch. Bank*, 5 Ch App. 444; *Hope* v. *International Financial Society*, 4 Ch Div. 327. This appears also to be the rule in California,[1] Kansas,[2] Maryland,[3] Missouri,[4] New Hampshire,[5] Ohio,[6] Tennessee[7] and Washington.[8]

But in most jurisdictions in the United States and in this Court the doctrine that a corporation cannot pur chase and hold its own stock unless expressly authorized so to do, is not recognized. *Fletcher Ency. of Corp.* Sec-

[1] *Bank* v. *Wickersham*, 99 Cal. 655; *Vercoutere* v. *The Golden State Land Co.*, 116 Cal. 410; *Schulte* v. *Boulevard Gardens Land Co.*, 164 Cal. 464.

[2] *Savings Bank* v. *Wulfekuhler*, 19 Kans. 60; *Abeles* v. *Cochran*, 22 Kans. 405; *Bank* v. *Strachan*, 89 Kans. 577; *Steele* v. *Telephone Assoc.*, 95 Kans. 580.

[3] *Maryland Trust Co.* v. *Mechanics Bank*, 102 Md. 608; *Burke* v. *Smith*, 111 Md. 624; *Schaun* v. *Brandt*, 116 Md. 560, and *Bear Creek Lumber Co.* v. *Bank*, 120 Md. 566. Recent legislative enactments permit a Maryland corporation to purchase shares of its capital stock out of surplus.

[4] *St. Louis Mfg. Co.* v. *Hilbert*, 24 Mo. App. 338; *Eggman* v. *Blanke*, 40 Mo. App. 318; *St. Louis Rawhide Co.* v. *Hill*, 72 Mo. App. 142; *Wilson* v. *Mercantile Co.*, 167 Mo. App. 305.

[5] *Currier* v. *Lebanon Slate Co.*, 56 N. H. 262; *Latulippe* v. *New England Investment Co.*, 77 N. H. 31.

[6] *Taylor* v. *Miami Exporting Co.*, 6 Ohio, 176; *State of Ohio* v. *Franklin Bank of Columbus*, 10 Ohio, 91; *Sanderson* v. *Iron & Nail Co.*, 34 Ohio St. 442; *State* v. *Building Assoc.*, 35 Ohio St., 258; *Coppin* v. *Greenlees & Ransom Co.*, 38 Ohio St. 275. Since the repeal of the Constitutional provision for double liability of stockholders of Ohio corporations, the majority rule may become established there. *Morgan* v. *Lewis*, 46 Ohio St. 1; *Siders* v. *The Concrete Co.*, 13 O. C. C. (N. S.) 481; *Mannington* v. *Hocking Valley Ry. Co.*, 183 Fed. 133.

[7] *Cartright* v. *Dickinson*, 88 Tenn. 476; *Herring* v. *Ruskin Co-operative Assoc.*, 52 S. W. 327.

[8] *Kom* v. *Cody Detective Agency*, 50 L. R. A., N. S. 1073; *Barto* v. *Nix*, 15 Washington, 563; *Tait* v. *Pigott*, 32 Washington, 344; 38 Washington, 59.

tion 1136; *1 Cook on Corporations,* 7th Ed. Section 311. The exercise of the right, however, is subject to the limitation that it must be without prejudice to the rights of stockholders and of creditors.

That the assets of a corporation constitute a trust fund for the benefit of creditors is elementary. Purchase by a corporation of its own stock constitutes a reduction of the capital assets which are subject to the claim of creditors. In many jurisdictions it is now held that a corporation may purchase its own stock only when it has a surplus sufficient in amount to enable it to purchase the shares of stock without impairing the capital stock. In other jurisdictions a surplus is not required, but stockholders may not have a preference over creditors and the ability of a corporation to pay its creditors must not be impaired by such purchase.

We set forth herewith in Appendix B, the decisions in the leading jurisdictions in this country which amply sustain the propositions herein set forth.

When the stock of the Reading Company was created the right of a corporation in Pennsylvania to acquire its own stock had been settled. Limitations had been imposed on the exercise of the right but the boundaries of the limitations were not clearly defined. In *Coleman* v. *Columbia Oil Co.,* 51 Pa. St. 74, the right of a corporation to purchase its own stock was recognized in the lower Court. Stowe, *A. J.,* said:

> "I am of the opinion that a corporation, under its general corporate powers, may purchase its own stock, when the act is done in good faith for the benefit of the corporation."

On appeal, counsel for the plaintiff contended that the purchase by the corporation of its own stock was *ultra vires,* but the court denied the plaintiff, a stockholder in the corporation, the right to question the transaction after

it had been consummated. Of the right of a corporation to purchase its own stock, Woodward, *C. J.*, said:

> "The employment of corporate funds to speculate in the stock of the company to which the funds belong, is not a practice to be encouraged; but the present plaintiff is not in position to censure the practice."

In *Columbia Bank's Estate,* 147 Pa. 422 (1892), the Supreme Court of Pennsylvania held that an *insolvent* corporation could not purchase its own stock. In that case the Bank issued certificates of deposit in consideration of the sale to it of shares of its stock. The Court found that the corporation was insolvent at the time and that the vendor of the stock either had or was chargeable with notice of such insolvency. The Court denied the certificates of deposit issued in consideration of the sale of the stock the right to participate upon distribution in insolvency proceedings in the assets of the Bank. With respect to the right of the corporation to purchase its own stock, the Court said:

> "It is well settled in England that a purchase by a corporation of its own stock is *ultra vires,* unless the power to purchase it is clearly conferred by its charter. In our country the decisions on this point are conflicting, but they are practically unanimous in holding that an insolvent corporation cannot buy its own shares to the detriment of its creditors. As its capital stock is a trust fund for the payment of its debts, the use of this fund in the purchase of shares, in itself, is destructive, of a security intended primarily for the creditors, and a plain misappropriation of it. If the corporation was permitted so to use the trust fund, it might in this way distribute its capital among its shareholders, extinguish their personal liability and leave its creditors without security or remedy. We cannot concede that it has a power which would make such results practicable."

But in *Dock* v. *Schlichter Jute Cordage Co.*, 167 Pa. 370 (decided in April, 1895), the Supreme Court of Pennsylvania affirmed the right of a corporation to purchase its own stock. The Court approved the Master's report which is set forth in the decision in full. The report said:

> "A corporation has the right to acquire stock of its own, where the transaction is not prohibited by statute, is *bona fide et sine malo ingenio. State Bk.* v. *Fox*, 3 Blatch. C. C. Rep. 431; *Bank* v. *Bruce*, 17 N. Y. (Ct. of App.) 507; *Coleman* v. *Oil Co.* 51 Pa. 74, and *Clapp* v. *Peterson*, 104 Ill. Rep. 26. No statute prohibitory of such dealing is known in Pennsylvania, and no right of creditors or of others than the shareholders has appeared in this case, and as to the latter nothing contrary to good faith."

The decisions clearly imported a limitation upon the right of a corporation to acquire its own stock and a prudent lawyer drafting a provision giving a corporation the right to repurchase its stock, would not have disregarded the contemporaneous decisions which declared such a limitation. A provision for the right to purchase back, stock of the corporation without limitation might have been subject to a defense of *ultra vires* on the ground that the provision properly interpreted gave the corporation the right to purchase its stock notwithstanding that the exercise of such a right might be detrimental to its creditors or stockholders.

The wisdom of the draughtsmen in providing that the right of redemption shall be exercised only if it is allowed by law at the time when the exercise of the right is sought, is demonstrated by the subsequent decisions in Pennsylvania and elsewhere (see Appendix B). In Pennsylvania, it is now clearly the law that a corporation may not purchase its own stock if creditors or stockholders are injured thereby. *Warren* v. *Queen & Co.*, 240 Pa. 154; *Wolf* v. *Excelsior A. S. & S. Co.*, 270 Pa. 547, (1921).

The Reading Company may at this time repurchase

the preferred stock. Its assets are such that its creditors would not be injured thereby.

c. *The right to issue preferred stock implies the right to redeem it, but the right to redeem is subject to limitations.*

Even if we regard the right to redeem as a right independent of the right of a corporation to purchase its own stock and not subject to the limitations of the right to purchase, full scope and effect is given to the language "if such redemption shall then be allowed by law".

Where a corporation is authorized to issue preferred stock it has implied power to attach a provision for its redemption, *Fletcher Ency. of Corp.*, Section 3644; *Coggeshall* v. *Georgia Land & Inv. Co.*, 14 Ga. App. 637; *Abrahams* v. *Medlicott*, 86 Kans. 106; *1 Cook on Corp.*, 7th Ed., Section 270; *Hoffman* v. *Penn. Warehousing & Safe Dep. Co.*, 1 Pa. C. C. R. 598 (1886); *Hackett* v. *Northern Pac. R. R. Co.*, 36 N. Y. Misc. 583, 73 N. Y. Supp. 1087.

In *Hackett* v. *Northern Pac. R. R. Co.*, 36 N. Y. Misc. 583, the preferred stockholders sought to resist the redemption of preferred stock by the Northern Pacific Railway Company. The corporation was authorized by its charter to issue preferred stock but there was no restriction or limitation placed upon it as to the terms and conditions upon which such stock was to be issued except that the Company might at its option make it convertible into common stock.

The certificate of preferred stock contained the following clause:

> "The company shall have the right at its option, and in such manner as it shall determine, to retire the preferred stock in whole or in part, at par, from time to time upon any first day of January prior to 1917."

With respect to the right of redemption, JUDGE SCOTT said (at p. 587):

> "Preferred stock, in its very nature, is stock which is held under a different contract and subject to different conditions, from those under which common stock is held. It is, of course, competent for the Legislature to prescribe what these conditions shall be and to forbid all others. It may, however, leave the determination of that question to the company itself, and it does so leave it when it fails to specify and limit the conditions. The Legislature of Wisconsin placed no limitation upon the terms which this Company might attach to its issue of preferred stock, and, therefore, left it to determine those terms for itself."

The right of redemption which was considered in *Hackett* v. *Northern Pacific R. R. Co., supra,* was again sustained by the Circuit Court of Appeals of the Eighth Circuit in *Weidenfeld* v. *Northern Pac. R. R. Co.,* 129 Fed. 305.

In *Hoffman* v. *Pennsylvania Warehousing & Safe Dep. Co.,* 1 Pa. C. C. R. 598 (1886), it had been held that where the directors of a corporation are authorized to increase the capital stock of the company and to borrow money on bond and mortgage they may issue preferred stock, preference being given only to the extent of legal interest if earned, the stock to be redeemable out of the net earnings only.

But it is not lawful for a corporation to redeem its preferred stock by appropriation of the assets of the company which are necessary to pay creditors. *Ellsworth* v. *Lyons,* 188 Fed. 55. The rights of preferred stockholders are subordinate to the rights of creditors, and the assets of the corporation cannot lawfully be used to redeem the stock until corporate debts have been paid

or provided for. *Westerfield-Bonte Co.* v. *Burnett,* 176 Ky. 188; 195 S. W. 477.

It has also been held that a provision for the redemption of preferred stock which permits the preferred stockholders to receive the assets of the corporation in preference to creditors is contrary to public policy and void. *Spencer* v. *Smith,* 201 Fed. 647. Such is clearly the law of Pennsylvania. *Warren* v. *Queen & Co.,* 240 Pa. 154.

That a corporation could not redeem preferred stock to the detriment of its creditors and stockholders was intimated in 1879 by the Supreme Court of Pennsylvania in *Culver* v. *Reno Real Estate Co.,* 91 Pa. 367. A stockholder brought suit for the redemption of preferred stock basing his right upon a provision contained in the stock certificate. The court said:

> "No argument or authority is required to prove the gross injustice to creditors and stockholders that must inevitably ensue, if preferred stock is allowed to take all the money from the treasury, and thereby cripple or break down the business of the corporation * * * The statute authorizes no such thing."

d. *The language "if such redemption shall then be allowed by law" was added to prevent unlawful exercise of the right of redemption.*

In order to prevent any interpretation of the right of redemption as being contrary to public policy, it was therefore prudent in 1895 to include language which would prevent the exercise of the right to the detriment of stockholders and creditors. *Spencer* v. *Smith,* 201 Fed. 647. For that purpose the language "if such redemption shall then be allowed by law" is apt.

e. If a statute applicable to the Reading Company authorizing redemption of preferred stock is necessary, such a statute exists.

Counsel for Kurtz stated with respect to the redemption provision (Steno. Min. p. 84):

> "Nobody knows exactly why they put it in that way, but presumably because at the time the stock was issued there was no statute of Pennsylvania which authorized this Company or any similar company to redeem its preferred stock. There has been no statute since which applies to the Reading Company."

We understand this argument to mean that the contract requires that at the time when redemption of the preferred stock is sought there be in existence a statute applicable to the Reading Company, permitting the redemption of preferred stock. But we are of opinion that such a Statute exists.

The Reading Company was incorporated under the name of Excelsior Enterprise Company by special act. The act, approved May 24, 1871 (P. L. 1871, p. 1089) gave it the rights which had theretofore been conferred upon the Pennsylvania Company under an act approved April 7, 1870 (P. L. 1870, pp. 1025-1028), and the supplement thereto approved February 18, 1871 (P. L. 1871, p. 92).

The Pennsylvania Constitution of 1857 which was in effect at the time when the special act incorporating the Reading Company was adopted, provided in Section 26, Article 1 thereof, as follows:

> "The Legislature shall have the power to alter, revoke or annul, any charter of incorporation hereafter conferred by or under any special or general law whenever, in their opinion, it may be injurious to the citizens of the commonwealth; in such manner however, that no injustice shall be done to the corporators."

This provision was perpetuated by Section 10 of Article 16 of the Constitution of Pennsylvania, of 1874, which provides:

> "The general assembly shall have the power to alter, revoke or annul any charter of incorporation now existing, and revocable at the adoption of this constitution, or any that may hereafter be created, whenever, in their opinion it may be injurious to the citizens of this Commonwealth, in such manner, however, that no injustice shall be done to the corporators."

The charter of the Reading Company was therefore subject to the right of the Legislature to alter, revoke or annul the same, subject to the conditions in the constitutional provisions set forth.

The supplement to the act approved February 18, 1871, creating the Pennsylvania company and which applies likewise to the Reading Company, provided:

> "That the capital stock of said company as authorized by said Act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said Company may from time to time determine; and the said company are hereby authorized and empowered to issue said stock, or any portion thereof, in payment of any debt or liability incurred in the purchase of any property, or they may sell or dispose of any portion of said common or preferred stock, on such terms and conditions as the company may agree upon with any party or parties, company or companies, or in the doing of any other act authorized by the provisions of the act to which this is a supplement."

The provisions just quoted authorized the issuance of the preferred stock of the Reading Company. By an Act of the Legislature of the State of Pennsylvania entitled "An Act to authorize corporations to issue pre-

ferred stock, approved April 3, 1872 (1872 P. L. 37), provided:

> "That it shall be lawful for any company now or hereafter incorporated, *by or under any general law of this Commonwealth,* to issue with the consent of a majority in interest of its stockholders, preferred stock of the company, not exceeding at any time one-half of the capital stock of the corporation; the holders of which preferred stock shall be entitled to receive such dividends thereon, not exceeding twelve per cent per annum, as the board of directors of said company may prescribe, payable out of the net earnings of the company; and the holders of said preferred stock shall not be liable for any debts of the company." (Italics ours.)

By a further act of the Legislature entitled "A Supplement to an Act entitled 'An Act to authorize Corporations to issue Preferred Stock', approved the 3rd day of April, Anno Domini 1872", approved April 28, 1873 (Pa. L. 1873, p. 79), it was provided:

> "That any company authorized by the act to which this is a supplement, to issue preferred stock, may issue the same in different classes, to be distinguished in such manner as the directors of such company may prescribe; and they may give to the various classes such order of preference in the payment of, dividends, or in the rate of dividends thereon or in the redemption of the principal thereof, as may be approved by the holders of a majority of the stock of the Company; and the *company shall have the right to redeem its preferred stock* upon such terms as may be prescribed in the issue thereof; and it may specifically appropriate for the payment of the dividends upon any class of stock, or for the redemption of the principal thereof; the revenues from any specific department of its business or the proceeds of any specified portions of its assets or property: *provided, That no injustice shall thereby be done to the existing rights of other stockholders or creditors of the company.*" (Italics ours.)

Neither the Act of April 3, 1872, nor the act of April 28, 1873, applied to the Reading Company because the Reading Company was organized under a special law and not under *any general law of the Commonwealth of Pennsylvania.*

Until a comparatively recent period, the great majority of Pennsylvania corporations were formed under the provisions of special acts. These special acts not only provided for the incorporation of the corporations to which they related respectively, but defined their powers, prescribed regulations for their government and defined their relations with the public. The body of statute corporation law of Pennsylvania was therefore for many years contained in these special acts. *1 Eastman, Private Corporations of Pennsylvania*, 4.

The Constitution of Pennsylvania of 1874 forever destroyed the power of the Legislature to thereafter create corporations by special laws. Section 7 of Article 3 of the Constitution provides (Purdon's Digest, 13th Ed. Vol. I, p. 152):

> "The General Assembly shall not pass any local or special law * * *
>
> (25) creating corporations or amending, renewing or extending the charters thereof."

Immediately upon the enactment of the Constitution of 1874, the Corporation Act of April 29, 1874 (P. L. 1874, p. 73, *et seq.*), which provided a uniform system for the formation of such corporations as might then be formed, was enacted.

The Act of April 29, 1874, made provision for the acceptance thereof by any corporation organized for any of the purposes named and covered by the provisions of the Act or in existence under the provisions of any general law of Pennsylvania, and upon such acceptance such corporations would acquire the rights conferred upon

corporations by the Act of April 29, 1874. Section 16 of the Act of April 29, 1874, provided:

> "Every corporation created under the provisions of this act or accepting its provisions, may, with the consent of a majority in interest of its stockholders, obtained at a meeting to be called for that purpose, of which public notice shall be given during thirty (30) days in a newspaper of the proper county, issue preferred stock of the corporat on, the holders of which preferred stock shall be entitled to receive such dividends thereon as the board of directors of the corporation may prescribe, payable only out of the net earnings of the corporation."

It has been held that corporations organized under the Act of April 29, 1874, acquired the rights conferred by the Act of April 3, 1872, and the Act of April 28, 1873, upon corporations organized under a general law. *Warren* v. *Queen & Co.*, 240 Pa. 154 (1913). The provisions for the redemption of the preferred stock contained in the Act of April 28, 1873, are applicable to preferred stock issued under the provisions of Section 16 of the Act of 1874. *Warren* v. *Queen & Co., supra.*

The provisions of the Act of 1873 with respect to the redemption of preferred stock and the provisions of the Act of 1874 to which they were applicable remained in effect until the adoption of the statute of May 28, 1913, which broadened the scope of the Act of 1873 and in effect extended its provisions to a corporation organized either under the *general* or the *special* laws of the State of Pennsylvania. It applied both to corporations theretofore organized as well as corporations thereafter organized in the same manner as did the statute of 1873, and it therefore comprehended corporations which, like the Reading Company, were created by special act. It repealed all other statutory provisions covering the subject matter, leaving the Act of May 28, 1913, to embody all of the statutory law then in effect on the subject of the redemption of preferred stock.

Section 1 of the Act of May 28, 1913 (P. L. 1913, p. 378), provided as follows:

> "Section 1. Every corporation heretofore or hereafter incorporated *under the laws of this Commonwealth,* * * * may,—at the time of its incorporation, by provisions inserted in the certificate of incorporation, or at any later time with the consent of a majority in interest of its stockholders, obtained at a meeting to be called for that purpose, of which public notice shall have been given during sixty (60) days in a newspaper of the proper county, which county shall be that in which the principal office of the corporation in this Commonwealth shall be located,—issue preferred stock of such corporation. Said preferred stock may be issued in one or more classes, in such amounts for each class, without regard to the amount of any other class or the amount of common stock, and with such designations, rights, privileges, limitations, preferences, and voting powers, or prohibitions, restrictions, or qualifications of the voting and other rights and powers, *and upon such terms as to redemption of any class thereof,* at not less than par, or for its conversion into any other class of stock, common or preferred, as may be set forth in the original certificate of incorporation, or as may be approved and adopted by the corporation at the time of the authorization and issuing thereof. The rate of preferred dividend for any class of stock shall not exceed ten (10) percentum per annum. Such preferred stock may be issued for cash or property, or through the conversion of common stock, or through all or more than one of said methods." (Italics ours.)

Section 4 of the Act of May 28, 1913, which contains the repealing clauses clearly shows that the Act was intended to apply to corporations which, like the Reading Company, were organized under special act. It provides:

> "Section 4. The following acts of Assembly, and parts of acts; namely,—'An act to authorize corporations to issue preferred stock', approved the

3rd day of April, Anno Domini 1872 (Pamph. Laws 37);

A supplement to an act, entitled 'An act to authorize corporations to issue preferred stock', approved the 3rd day of April, Anno Domini 1872', which supplement was approved the 28th day of April Anno Domini 1873 (Pamp. Laws 79);

Section 16 and Clause 1 of Section 39 of an act, entitled 'An act to provide for the incorporation and regulation of certain corporations' approved the 29th day of April, Anno Domini 1874 (Pamp. Laws, 73),—and all other acts and parts of acts *general or special,* inconsistent herewith be and the same are hereby repealed."

Hence, even if we were to assume that the language "if such redemption shall then be allowed by law" requires that there be in existence a statute authorizing the redemption of preferred stock, such a statute exists; it applies to the Reading Company and whatever doubt may have ever existed as to the ability of the Reading Company to exercise the right of redemption is therefore removed.

In 1915 the Act of May 28, 1913 was amended but its purport and substance remained unchanged. In 1921 (P. L. 1921, 1159 *et seq.*) an Act of the Pennsylvania Legislature repealed all of the Act of May 28, 1913 except the repealing provisions thereof (Section 4 hereinabove set forth) and substituted in place of the acts repealed provisions similar in character and substance with additional provisions. The statute enacted in 1921 is even more pointedly directed to a company like the Reading Company than the act of May 28, 1913. The Act of 1921 provides:

"Section 1. Be it enacted, &c., That every corporation, heretofore or hereafter incorporated under the laws of this Commonwealth * * * may create two or more kinds of common stock and two or more kinds of preferred stock at the time of its incor-

poration by provisions inserted in the certificate of incorporation, or, at any later time, with the consent of a majority in interest of its stockholders having voting power obtained at a meeting to be called for that purpose. Notice of the time, place and purpose of such meeting shall be published, once a week for sixty (60) days prior to said meeting, in a newspaper of general circulation and in the legal journal, if any, of the county in which the principal office of the corporation in this Commonwealth is located. Such classes of stock may, from time to time, be authorized and issued out of the unissued stock of the corporation. Such stock may be issued in one or more classes, in such amounts for each class, without regard to the amount of any other class or the amount of unqualified common stock, and with such designations, rights, privileges, limitations, preferences, and voting powers, or prohibitions, restrictions, or qualifications of the voting and other rights and powers, *and upon such terms as to redemption in any class thereof at not less than par, and convertible or not into any other class of stock, common or preferred,* as may be set forth in the original certificate of incorporation, or *as may be approved and adopted by the stockholders at the time of the authorization or at any time prior to the issuance thereof.* The rate of preferred dividend for any class of stock shall not exceed ten per centum (10%) per annum. Such stock may be issued for cash or property, or in exchange for other stock of the corporation, or through all or more than one of said methods; and the stock so exchanged for such preferred stock and returned to the corporation may be issued again by the corporation.

* * * * * *

Section 3. The rights, privileges, and terms and conditions of any class of stock, issued and outstanding as above provided, shall not thereafter be subject to alteration or change without the consent of all the holders of such class of stock, except as may be otherwise provided by the certificate of incorporation or by the resolutions authorizing the issue of the same." (Italics ours.)

We have demonstrated the validity of the right to redeem the preferred stock solely because that right, in our opinion, bears upon the dividend rights and the rights upon dissolution of both the preferred and the common stock and limits the preferred stock to a realization of no more than its par value.

2. The question as to whether the preferred stock is entitled to a preference out of accumulated surplus is not involved here, and in any event the contention that it is so entitled is without merit.

Upon the oral argument, it was contended that the common stock is not prejudiced by carrying out the decree below because the preferred stock is entitled to a preference out of accumulated earnings. In the Kurtz brief, it was contended that common stock is prohibited from receiving dividends except from earnings of a preceding year, but that in case in any one such year there are no earnings, or earnings insufficient to pay the preferred stock its full dividends, the preferred stock may be paid dividends for such year out of accumulated surplus. It was therefore contended that the present accumulated surplus should not be devoted solely to the paying of dividends on the common stock.

The common stockholders' contention is not that surplus accumulated in any year in which the full 4% preferred dividend is not paid to the preferred stockholders should be available for the common stockholders, but that surplus accumulated in any year in which and after full 4% dividends were paid to the preferred stockholders should go exclusively to the common stockholders. Since 1903, the preferred stockholders have received their full 4% dividends (R. 58). That portion of the present accumulated surplus of the Reading Company which was

accumulated prior to 1903 is in these proceedings negligible.*

The argument of the preferred stockholders is that although the preferred has received its full 4% dividends since 1903, nevertheless, out of the surplus accumulated since 1903, the preferred is still entitled to participation because, they say, there may come a year in the future wherein the earnings will be insufficient to pay full dividends on the preferred stock, and in such case, the surplus accumulated since 1903 would be available for dividends upon the preferred stock.

Whatever may be the legal rights arising upon such a possible future contingency, that contingency is not at hand. The surplus is, at the present moment, about to be distributed. The preferred stockholders received their full 4% dividends last year, and are receiving them this year and no one has intimated that they will not receive them next year. The common stockholders' position is that their legal rights to the benefits now proposed to be distributed by way of interests or "rights" in the stock of the New Coal Company are the same as if an equivalent amount of cash received upon a sale of the coal property to the public were being distributed. The common stockholders contend that in the actual situation which is at hand, since the preferred stockholders have received their full 4% dividends, they are excluded from any participation in a distribution out of the accumulated surplus which has arisen since 1903.

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* The largest amount of the accumulated surplus of the Reading Company which can possibly be claimed to have been earnings of years in which full dividends were not paid upon the First Preferred and Second Preferred Stock is $2,263,159.56 which represents the accumulated surplus of the Reading Company on June 30, 1903 (R. 259). It is probable that the amount is less, depending upon whether or not the dividends on the Preferred Stock for the year 1903 were paid out of earnings for the year ending June 30, 1903, or the earnings of the year ending June 30, 1902. If paid out of the net earnings of the year ending June 30, 1902, the accumulated surplus for years in which full dividends upon preferred and common were not paid is $1,239,911.71 (R. 259).

We have, we believe, demonstrated that if the coal properties or stock of the Coal Company were sold, and the resulting proceeds placed in the treasury of the Reading Company, there can be no question that such proceeds must go exclusively to the common stockholders, if they were now to be distributed to stockholders.

Therefore, even though the preferred stockholders were entitled to a preference out of accumulated surplus when current earnings were insufficient to pay their dividends (and we contend that they are not so entitled) no such question arises on the facts before the Court.

We contend, however, that the holders of preferred stock are not entitled to a preference out of accumulated surplus even as to years in which current earnings are not sufficient to pay full dividends on preferred stock.

Every presumption is opposed to the right of the preferred stockholders to a preference of 4% per annum out of accumulated earnings. No dividends have ever been paid them out of accumulated earnings, notwithstanding the fact there have been years in which current earnings were *insufficient* to pay them their dividends and there existed at that time an accumulated surplus (R. 259).

The contention that the preferred stock is entitled to a preference out of accumulated surplus arises from a failure to read the stock certificate as a whole. Severance of the first three sentences from the body of the certificate of First Preferred Stock (Exhibit C, R. 88, 89) is necessary, and without such severance the argument can scarcely be advanced (see Kurtz Brief, pp. 30, 31). When we read the certificate as a whole it appears that the preferred dividends out of the net profits of any particular year are the *"full"* dividends. The whole history of the preferred stock establishes that it was issued as a translation of the rights of creditors under Income Bonds into preferred stock (R. 221, 222, and see our Reply Brief,

pp. 16, 17). The preferred stock was issued in the main to previous creditors who were holders of Income Bonds in the old Company (R. 221, 222). As such they were entitled to interest out of the earnings of a particular year only. If the earnings of that year were insufficient to pay the interest, it was lost forever.

It is unquestioned in this case that the common stock is entitled to all earnings in particular years in excess of the amount required to pay dividends to the preferred stock for such particular years, and that the preferred stock has no right to share in such excess earnings for such particular years. The preferred stock is not cumulative. It is difficult to conceive why earnings to which the common stock is exclusively entitled, should, because they were not declared as dividends in the particular years when earned, revert to the preferred stock as a back log for the payment of dividends not earned in any one year, and deprive the common stock forever of all right in them.

3. The argument that the common stock is excluded from participation in accumulated surplus because of the language "excluding undivided net profits remaining from previous years" is without foundation.

Argument is made in the Kurtz Brief that the common stock is entitled to dividends only out of the business of a particular fiscal year and that because of the language "excluding undivided net profits remaining from previous years" the common stock is excluded from participation in the accumulated surplus.

If the words, "excluding undivided net profits remaining from previous years" be entirely omitted from the clause "if from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, * * * there shall remain net profits"

the meaning of that clause would not be affected or changed in any way or to the slightest degree. The net profits remaining from previous years are no part of the business of the current fiscal year nor are the undivided profits of previous years derived from the business of the "particular fiscal year" in question. Reading the certificate as a whole it would appear that the language "excluding undivided net profits remaining from previous years" was inserted to meet the objection probably interposed at the time when the certificate was drafted, that the provision—

> "But no dividends shall in any year be paid upon any such stock" (*i. e.*, common) "out of the net earnings of any previous fiscal year in which full dividends shall not have been paid on the First and Second Preferred Stock"

was not completely safeguarded without some such language in the previous sentence. The language "excluding undivided net profits remaining from previous years" is really surplusage, inserted out of abundance of caution.

If it had not been intended that the common stock should be paid dividends out of the surplus net profits of any particular fiscal year after payment of the dividends upon the preferred stock whenever such payment should be declared (whether in the next succeeding or any succeeding year), there would have been no reason whatsoever for the provision "but no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year *in which the full dividends shall not have been paid on the First and Second Preferred Stock.*" The exclusion of the common stock from net profits of a fiscal year in which full dividends shall *not* have been paid on the preferred stock, is the equivalent of authorization, if authorization were

necessary, for participation of the common stock in th earnings of any previous year remaining after payme of *"full"* dividends upon the preferred stock, whenev dividends from such earnings of any previous year shou be declared.

No analysis or refinement of language can diminis the binding force of the undisputed facts in the Recor that preferred stock has never been paid more than 4% per annum, and common stock has received more tha 4% per annum for a decade without objection. Ther can be no possible question from the practical interpre tation of the parties, that after the preferred stock re ceived its 4% dividend out of the profits of any particu lar fiscal year, it was entitled to nothing further.

The argument of the Kurtz brief, if sound, would result in that so long as 4% is paid on the preferred stock, neither common nor preferred stock, are entitled to any dividends out of accumulated surplus; the com mon stock would *never* receive any dividends out of accu mulated surplus, the preferred stock *only* when current earnings were insufficient to pay the 4% dividend on the preferred stock. To achieve any such unusual and re markable result, express language would be necessary. If the accumulated surplus was to be a perpetual guar anty fund for the payment of the dividend on the pre ferred stock, it would have been easy to say so and it would have been said.

IV.

Appellants had no opportunity to participate in determining what the basis is upon which the amount and character of payments to be made by the Coal Company and by the New Company to the Reading Company was arrived at, and have had no clear statement of the basis. The basis was arrived at by the Board of Directors of the Reading Company which Board is and was controlled by the New York Central and the Baltimore & Ohio Railroad Companies. The grounds urged in support of the basis are without merit.

The plan provides for the payment by the Coal Company to the Reading Company of $10,000,000 in cash or current assets; this was probably required because the original plan provided for the payment of such amount to the bondholders for the release of the stock of the Coal Company from the General Mortgage. Such payment is and was in our opinion unnecessary (R. 70, 71) and would be unnecessary even though the stock is released from the General Mortgage (*supra*, pp. 23-25). Under the provisions of the plan, the Coal Company is to deliver to the Reading Company $25,000,000 new 4% Mortgage Bonds. It is probable that these $25,000,000 of bonds with the $10,000,000 in cash or current assets represent what, in the opinion of the board of directors of the Reading Company from whom the original plan emanated, the Coal Company should pay for a release of its property from the General Mortgage.

The plan also provides for the payment (Par. 5 of the Plan, R. 275):

> "by the new corporation to the Reading Company of the sum of $5,600,000 and its agreement to issue its

> shares to the stockholders of the Reading Company" * * * "The new Corporation will issue 1,400,000 shares of stock without par value. Such no par value stock will be sold by the New Corporation to the stockholders of the Reading Company, preferred and common, share and share alike, for $5,600,000 or $2.00 for each share of Reading stock."

In effect, therefore, the New Coal Company was to pay to the Reading Company an amount equal to $4.00 for each share of its capital stock (1,400,000 shares) and the New Coal Company would receive that amount from the stockholders of the Reading Company.

We have been unable to obtain any clear statement as to the basis upon which the price of $4.00 per share for the stock of the Coal Company was arrived at. The answer of the Reading Company stated (R. 163):

> "This consideration is less than it is hoped would prove to be the intrinsic value of the coal property. It is, however, a substantial, not a nominal, consideration and is in the judgment of the board of directors of the Reading Company adequate for the requirements of the Reading Company."

We believe we have demonstrated that the stock of the Coal Company is being sold for an amount much less than its value, and in this counsel for the appellees would appear to concur. Counsel for the Reading Company upon oral argument stated:

> "Now there never has been any thought in the minds of counsel of the Reading Company that the selling price of the certificates of interest was as great as their value. There has never been any doubt in the minds of the Reading Company or in the minds of the Reading board nor was there any doubt in the mind of the District Court that the right to subscribe for those certificates of interest is a valuable right" (Steno. Min. of Argument, pp. 53, 54).

Counsel for Joseph E. Widener frankly stated that the stock was worth more than $4.00 per share. The colloquy was as follows:

"Now, this new company gets the coal property, and this new company pays $5,600,000 into the Reading treasury for the coal property.

MR. JUSTICE MCREYNOLDS: How much is it worth—that coal property?

Mr. Ballard: It is worth more than that.

MR. JUSTICE MCREYNOLDS: How much?

Mr. Ballard: It is worth, perhaps, $30,000,000 or $40,000,000 more than that. You asked that question of Mr. Cook; he gave you several tests. One was the——

MR. JUSTICE MCREYNOLDS (Interposing): Just give me your own view of it.

Mr. Ballard: My view is this: That this property during the past five years, which your Honor said were abnormal years, earned an average of $4,400,000. If you capitalize that at 7 per cent, which is a fair way to arrive at a value, as I think we will agree, you get a valuation of this property of $60,000,000—call it $4,200,000, and divide it by 7.

If you capitalize it at 6 per cent, you get a valuation of $70,000,000.

Now, of that $60,000,000 or $70,000,000, $40,000,000 goes back into the treasury of the new Reading Company—$10,000,000 in cash; $25,000,000 in bonds, and $5,600,000 for what is, perhaps, an inadequate consideration.

Now, your Honor also asked Mr. Cook——

MR. JUSTICE MCREYNOLDS (Interposing): Well, I would like to know what you estimate as the value of the thing which is going to be sold for $5,600,000?

Mr. Ballard: I estimate the value of that thing at from $60,000,000 to $70,000,000, less the $35,000,000 that is taken out. I estimate the value of that thing at from $35,000,000 to $40,000,000.

MR. JUSTICE MCREYNOLDS: All right" (Steno. Min. pp. 65, 66).

Counsel for Kurtz said:

> "The complaint which is made here by the appellants to the effect that the preferred stock ought not to share in what they refer to as the 'distribution' of the coal stock, *which does give them something of value, I think, over and above what they pay for it* —their contention is based entirely on the proposition that the surplus of the Reading Company is the property of the common stockholder" (Steno. Min. p. 71). (Italics ours.)

Counsel for the Iselin Committee stated:

> "Now it has been said and it may be taken for the purposes of this argument—and it must be taken —that the stock has a greater value than $2 per share; precisely what, is a matter of speculation" (Steno. Min. p. 95).

There could be no question that $4 per share did not represent the value of the coal stock in the face of the earnings of the Coal Company, the book value of the stock and the vast extent of its properties, as set forth in III of our main brief.

It would appear that $4 per share for the stock of the Coal Company is now supported on a variety of grounds; by one appellee it is supported as a payment upon dissolution or action analogous to dissolution of the corporation; by another, as a payment by the stockholders upon a compulsory segregation of assets; by another, because it is necessary to get the vote of the preferred stockholders to support the plan;* by another of the appellees on the ground that the holders of pre-

* Counsel for Joseph E. Widener states (Steno. Min. p. 68):

> "The Plan here is a plan suggested by the Reading Company, and accepted by the court. We say that, if this satisfies the mandate of the Court, we will do this thing; and in order to do this thing, we must get the vote of the stockholders. You can only get a majority vote of these stockholders, if the preferred stock gets something out of it; for the preferred stock actually can deadlock this company, and practically controls it because the larger holdings are in the hands of a few—"

ferred stock are entitled at least to an equal share in accumulated surplus and by some of the appellees upon the theory that equity is equality and upon a combination of all of these grounds. It is difficult to perceive why a sale should be supported on any other ground than that it constitutes a disposition of property for its value. We have demonstrated that neither of the grounds now urged by the appellees will support the sale.

We have endeavored to determine the reason which moved the Board of Directors to propose a sale of the stock to the New Coal Company at $4 per share and we have been able to conclude merely that that basis was urged because if the sale was valid as a sale, no inquiry would be necessary into the relative rights of preferred and common stockholders, and no further inquiry would be involved as to whether what was being done was a disposition of property or the declaration of a dividend.

V.

From the facts which we have been able to gather, we are forced to conclude that the retention by the Reading Company, when merged with the Railway Company, of the stock of the Reading Iron Company will be in violation of the Commodities Clause.

This Court in its opinion and mandate entered thereon directed the District Court to enter a decree dissolving the combination of the Reading Company and the Coal Company and the Railway Company—

> "with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that Company and from each other of the Philadel-

> phia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company * * * to the end that the affairs of all of these now combined companies may be conducted in harmony with the law."

The decree of the lower Court does not make the Railway Company independent of the Reading Company. It provides instead (Par. 6 of the Plan, R. 276):

> "The Reading Company will merge the Philadelphia & Reading Railway Company under the authority contained in the present charter of the Reading Company, and will subject the Railway property to the direct lien of the General Mortgage."

We do not believe that this Court by the language of its decree intended to preclude the merger of the Reading Company with the Railway Company. But such merger is not to be permitted if it brings about a result different from that which would be brought about (so far as the conduct of the affairs of these companies in harmony with the law is affected) if the Reading Company were to be separated from the Railway Company.

Had the Reading Company been separated from, instead of merged with, the Railway Company, no question would have arisen here with respect to the holding by the Reading Company of all of the capital stock of the Reading Iron Company. The merger of the Railway Company with the Reading Company makes the Railway Company the holder of the stock of the Reading Iron Company. This Court clearly intended by its opinion and its mandate that a decree entered in compliance with the mandate should not remove one form of illegality by substituting another. *United States* v. *St. Louis Terminal*, 236 U. S. 194, 205, 206.

We have sought to obtain the facts concerning the activities of the Reading Iron Company. But it is difficult to obtain them. Little is published, and little ap-

pears to be known. From the facts which, however, we have been able to gather and which we now submit to this Court, it would appear that the ownership of the stock of the Reading Iron Company by the Reading Company, after the merger, and the control exercised by the Reading Company over the Reading Iron Company would be repugnant to the provisions of the Commodities Clause.

The Reading Iron Company has issued and outstanding $1,000,000 par value of capital stock, all of which is owned by the Reading Company. The Reading Iron Company was organized under the laws of the State of Pennsylvania on April 12, 1889. Its activities as set forth in Poor's Manual of Railroads of 1921, are (p. 1695):

> "* * * the manufacture of wrought iron pipes and tubes but it also owns and operates blast furnaces, rolling mills, forges and foundries at Reading, Pottstown, Columbia, Emaus, Birdsboro and Danville, Pa. and a large bituminous coal property in Somerset County, Pennsylvania."

The stock of the Reading Iron Company has been pledged as security under the joint General Mortgage of the Reading Company and the Coal Company. Dividends of 6% per annum have been paid. An extra dividend of $1,500,000 was paid in 1909, one of $1,000,000 in 1911, one of $500,000 in 1914 and one of $750,000 in 1915 (Poor's Manual of Railroads, 1921, p. 1695).

The Reading Iron Company has no mortgage indebtedness. A copy of its Balance Sheet as of December 31, 1920, is annexed as Appendix "C". It appears therefrom that the value applicable to the capital stock of $1,000,000 is approximately $22,000,000. The stock of the Reading Iron Company is carried on the books of the Reading Company at $1,000,000 book value.

We are advised that the products of the Reading Iron Company are transported by the Railway Company or its subsidiaries and that it receives materials transported

over the rails of the Railway Company and its subsidiaries. We believe that the ownership by the Railway Company of all of the stock of the Reading Iron Company under the circumstances herein set forth is a violation of the Commodities Clause. Further investigation into the facts may be regarded as necessary and the Court has plenary power to direct the same.

The decree could, we repectfully submit, be brought in conformity with the law by directing that the stock of the Reading Iron Company be sold to purchasers independent of the Coal Company or of the Reading Company when merged with the Railway Company, free and clear of the General Mortgage, the proceeds to be subjected to the General Mortgage as set forth in II.

VI.

From such facts as we have been able to gather we are forced to conclude that the retention by the Reading Company when merged with the Railway Company of the stock of the Reading Iron Company creates a violation of Article 17, Section 5 of the Constitution of Pennsylvania of 1874.

The plan provides (par. 6, R. 276, 277) that the Reading Company when merged with the Railway Company will accept the Pennsylvania Constitution of 1874. Article 17, Section 5 of the Constitution of 1874 provides:

> "No incorporated company, doing the business of a common carrier shall, directly or indirectly, prosecute or engage in mining or manufacturing articles for transportation over its works; nor shall such company, directly or indirectly, engage in any other business than that of common carriers, or hold or acquire lands, freehold or leasehold, directly or indirectly, except such as shall be necessary for carrying

on its business; but any mining or manufacturing company may carry the products of its mines and manufactories on its railroad or canal not exceeding fifty miles in length."

Had the decree of the District Court followed the language of the opinion of this Court and established entire independence of the Railway Company from the Reading Company no question involving the provision of the Constitution of Pennsylvania just quoted would arise. It is well settled that a decree entered pursuant to the mandate of this Court may not be repugnant

> "to the exercise by the State authorities of their power * * * insofar as the jurisdiction of such authorities may have extended." (*United States* v. *St. Louis Terminal*, 236 U. S. 194, 207.)

From the facts set forth as to the activities of the Reading Iron Company in "V" it would appear to us that the holding of stock of the Reading Iron Company by the Reading Company when merged with the Railway Company is repugnant to the provisions of Article 17, Section 5, aforesaid.

Such would clearly appear to be the opinion of this Court as declared in *United States* v. *Reading Co.*, 253 U. S. 26. This Court, MR. JUSTICE CLARKE, writing, said (R. 17, 18):

> "When in 1896 the problem was presented of reorganizing the financial affairs of the two companies, it was not solved, as it might have been, by creating separate coal and railroad companies to conduct independently interstate commerce in the two departments to which their railroad and coal properties were adapted, but, on the contrary, *and very obviously for the purpose of evading the provision of the constitution of Pennsylvania prohibiting any incorporated common carrier from, directly or indirectly, engaging in mining 'articles' for transportation over its lines* (Constitution of Pennsylvania,

> 1874, Art. 17, Sec. 5), and also of evading the provisions of the Federal Anti-Trust Act against restraining and monopolizing interstate commerce, *resort was had to the holding company device,* by which one company was given unrestricted control over the other two, with the power, inherent in that form of organization, of continuing and carrying forward the restraint and monopoly which had previously been acquired over that large volume of interstate commerce which was to be conducted by the coal and railroad companies. (Italics ours.)

Such would also appear to be the opinion of the Attorney General of Pennsylvania. His opinion, dated January 2, 1897, with respect to the right of the Reading Company to hold the stock of the Railway Company and the Coal Company is set forth in the Record (R. 252-258). If the Railway Company could under the laws of Pennsylvania hold the stock of the Coal Company there would have been no need to resort to the device of placing the ownership of the stock of both companies in a company organized prior to the Constitution of 1874 and free from the operation of the provisions thereof. The Attorney General said:

> "It came to the notice of this Department that a plan of reorganization was contemplated, by which it was proposed that the stock of the two companies above mentioned should be held, owned and controlled by the corporation originally known as the Excelsior Enterprise Company, since changed to Reading Company, as above mentioned.
>
> *The obvious purpose of this part of the scheme of reorganization seemed to be to escape from that provision of the Constitution of 1874 which forbids any incorporated company doing the business of a common carrier, to directly or indirectly engage in mining or manufacturing articles for transportation over the line;* or, stated differently, the union of the Coal Company with the Railway Company." (Italics ours.)

The provisions of Article 17, Section 5, were intended to achieve the same result with respect to intrastate commerce that the Commodities Clause sought to achieve with respect to interstate commerce. (*United States* v. *Delaware & H. Co.*, 164 Fed. 215, 253). It aimed at a destruction of the dual and conflicting relation of public carrier and private producer. Whatever difficulty there may be in enforcing its provisions and whether or not it may or may not require legislation to enable the State to forfeit title to lands acquired in the face of the provision (*Commonwealth* v. *N. Y., Lake Erie & W. R. R.*, 132 Pa. 591, 19 Atlantic, 291), we are of opinion that this Court will not approve of a combination which would infringe upon the inhibitions of Article 17, Section 5 of the Constitution of 1874 (*United States* v. *Delaware & H. Co.*, 164 Fed. 215, 253).

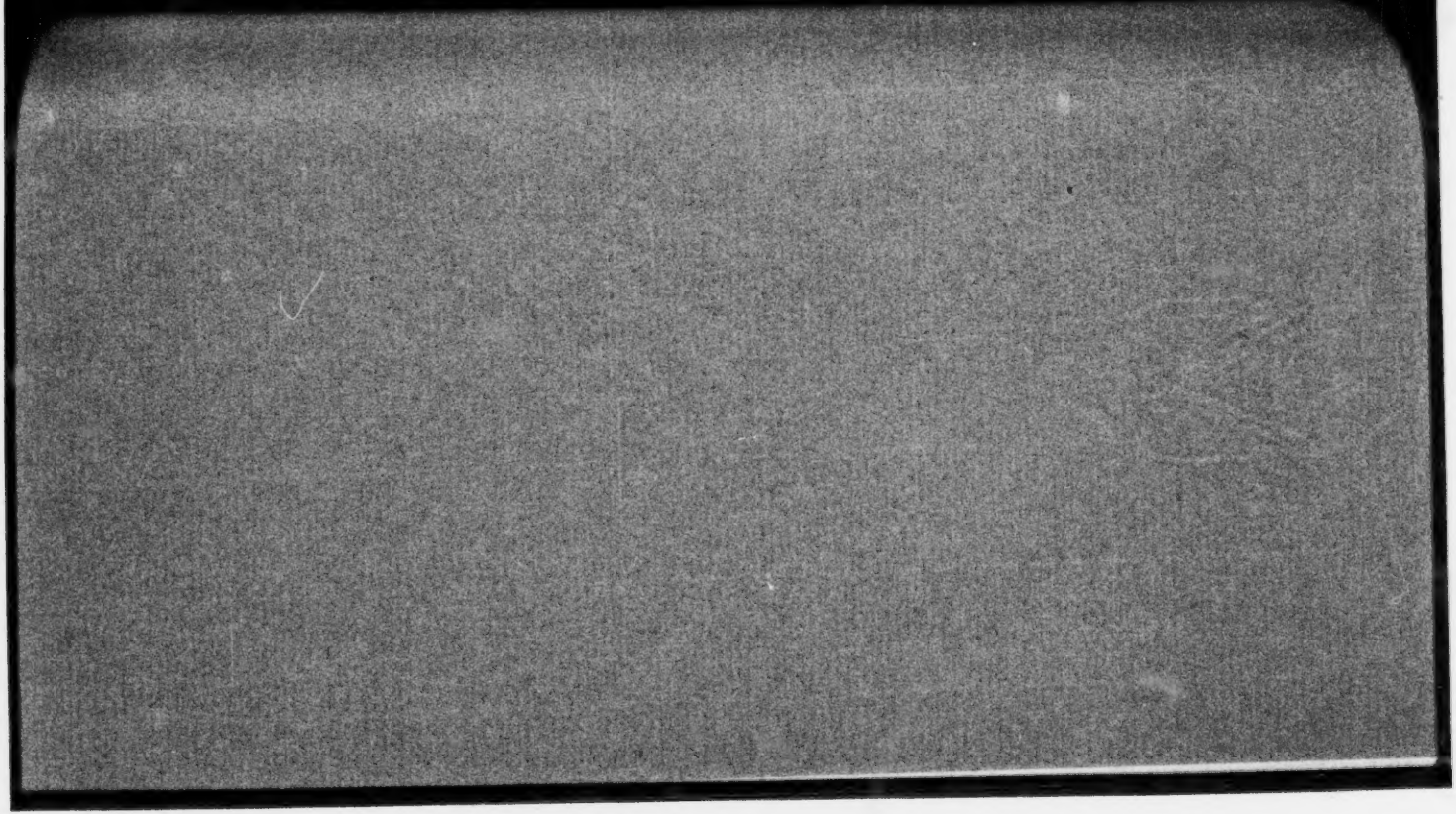
The violation of the Constitution of Pennsylvania may of course be obviated by directing a sale of the stock of the Reading Iron Company free and clear of the lien of the General Mortgage and the deposit of the proceeds of sale under the General Mortgage as suggested with respect to the stock of the Coal Company in II.

Respectfully submitted,

ALFRED A. COOK,
Attorney for Appellants.

ALFRED A. COOK,
FREDERICK F. GREENMAN,
ROBERT SZOLD,
of Counsel.

APPENDICES.



Appendix A.

No. 1584—In Equity.

United States of America,
Plaintiff,

vs.

The Lake Shore & Michigan Southern Railway Company, *et al.*,
Defendants.

In the United States District Court for the Southern District of Ohio, Eastern Division.

Decided July 30, 1915.

Before Warrington, Knappen and Denison, Circuit Judges.

Per Curiam. On May 22, 1915, the Sunday Creek Coal Company filed two petitions in the nature of interventions in the original suit, above named, in one of which petitions relief is asked against the Hocking Valley Railway Company, and in the other against the Bankers Trust Company; these three companies were defendants in the original suit (203 Fed. 295). The issues arising under the two petitions were presented and argued together, and will be disposed of in this opinion.

1. *Suit concerning Hocking Valley.* The relief sought against the Hocking Valley is to require the company to transfer and deliver to petitioner certain shares of stock in both the Buckeye Coal & Railway Company and the Ohio Land & Railway Company, and also particular mortgage bonds issued by the latter company. The Hocking Valley and the Chesapeake & Ohio Railway Company (another defendant in the original suit) moved to dismiss the petition concerning these securities, on the ground that the court is without jurisdiction to grant the relief

prayed. The Central Trust Company of New York, Trustee (another of the original defendants), filed an answer to this petition, alleging in substance that it holds such stocks and bonds as additional security for the payment of certain other bonds ($20,000,000 face value) secured by the first consolidated mortgage of the Hocking Valley and the Buckeye companies, dated March 1, 1899.

One of the complaints made in the original suit in effect was that there was an unlawful combination of railroad and coal interests. One object of the decree was effectively to separate these interests so far as either interest interfered with the free and independent control of the other. The coal properties in question had prior to the original suit been placed in the nominal control of the Sunday Creek Company (now called Sunday Creek Coal Company), though the stock of that company was controlled by the railroad companies. For the purpose of placing the coal properties within the exclusive control of the Sunday Creek Company, it was provided in the decree that the equity and interest of certain named railroads, including the Hocking Valley, in the capital stock of the Sunday Creek Company, as also the legal title to such stock which then stood in the names of trustees, should be disposed of by absolute sale. Under a later order the stock was sold to John S. Jones, the sale was confirmed, and he and his associates are in control of the Sunday Creek Company. The theory of the present claim, as we understand it, is that this company became entitled to the stocks and bonds now in issue at the time the coal properties were placed in its nominal control, as stated, and so they are to be treated as having constituted part of the company's assets at the time Jones purchased its stock.

We shall for present purposes assume that if upon any sound theory the stocks and bonds in question were part of the property represented by the stock sold to Jones, and if the proper parties are present, the court has

jurisdiction under the powers reserved in the final decree to enforce the transfer and delivery sought, since the exercise of such power would in principle and effect be nothing more than to place the purchaser in possession of property intended to be embraced in the sale. The only evidence offered in support of the claim of petitioner is contained in portions of the record in the original suit, and such orders as have been entered in effecting the sale. The portions of the record most relied on are paragraphs (7), (8), (9) and (10) of the findings of fact accompanying the decree of March 14, 1914. The 7th paragraph deals with the railroad reorganization of 1899 (see also 203 Fed. at pp. 301, 302); the 8th with the Trunk Lines' purchase of stock in the Hocking Valley (*ibid.* p. 304); the 9th with the railroad acquisition and control of coal properties (*ibid.* 302 mid. to 303 near bot.); and the 10th with the merger of the coal interests in the control of the Sunday Creek Company (*ibid.* 303 bot. to 304 mid.). In view of certain undenied allegations of the petition it will not be necessary to enter into the details of all these findings. The 9th paragraph of the findings begins with a reference to the plan of reorganization bearing date January 4, 1899. All that need to be said here of the railroad feature of this plan is that it involved the reorganization of the immediate predecessor-railroad of the Hocking Valley, viz., Columbus, Hocking Valley & Toledo Railway Company, and that it resulted, as stated in paragraph (7), in placing the property of the reorganized railroad and of certain other railroad companies in control of the Hocking Valley. The 9th paragraph finds: the Hocking Valley and the Buckeye Coal & Railway companies joined in the execution of a mortgage of March 1, 1899, which provided for the issue of first-mortgage bonds in the sum of $20,000,000. and for securing them through the properties acquired by the two companies; the Buckeye Company was organized for the purpose of taking over certain coal properties involved in the reorganiza-

tion mentioned; the purchasing trustees at the judicial sale bid in these coal properties and conveyed them to the Buckeye Company, receiving from the company 2495 shares of its capital stock of 2500 shares; the trustees then entered into a traffic agreement with the Hocking Valley and in consideration of which turned over to it the shares of coal stock so received; and out of sales proceeds of the first-mortgage bonds mentioned, the Hocking Valley acquired the stock and properties of four other coal companies, among which, as shown in the opinion in the original suit and here pointed out by counsel, were the stock and property of the Ohio Land & Railway Company (203 Fed. at 303). Still other stocks in coal companies were acquired by the Hocking Valley, as the 9th paragraph finds, and reference will be made to two of these companies when we come to consider the other petition.

The 10th paragraph (subdivision *b*) finds, among other things, that "The holdings in these coal properties were subsequently merged and placed in the Sunday Creek Company". Upon this language petitioner seems at last to rest its claim that the stocks and bonds in dispute are the property of the Sunday Creek Company. We do not think the language is open to such an interpretation, which would be opposed to the findings as a whole, and, indeed, to the facts deducible alone from the pleadings in the original suit. The findings show that the railroads and coal properties were separately grouped and placed under a common control. The question then of common control of the properties involved, whether railroad or coal properties, thus became and remained the issue of dominant importance rather than the means by which such control was acquired. For example, in a portion of the 10th paragraph, following the language so relied on and before quoted, and which describes the acreage of the coal lands and the number of coal mines and coke ovens, it is found that the Sunday Creek "controls" them, not that it owns them; and concededly, as will be seen, the

company controls the properties of the Buckeye and the Ohio Land & Railway companies by leases, not through ownership of the stocks and bonds in question. Upon turning to the pleadings of the original suit, admitted facts distinctly appear which negative the idea that the Sunday Creek Company acquired those stocks and bonds. By the 8th paragraph of the bill and the corresponding paragraph of the Hocking Valley answer, it was alleged and admitted that the Hocking Valley acquired the stock of the Buckeye and that of the Ohio Land & Railway Company. By paragraph XIV of the bill it was alleged that the Hocking Valley entered into an agreement of sale, in terms, of its coal stocks to the Central Trust Company, a copy of which agreement is attached to the bill as Exhibit E. This, it should be observed, is the same agreement which is set out in subdivision (*b*) of paragraph (10) of the findings, where the fact is found that in April, 1908, the entire capital stock of the Sunday Creek Company was placed in the names of two separate trustees, in anticipation of the effect of the commodities clause of the Hepburn act. This was done under separate though similar contracts by the Toledo & Ohio Central Railway Company (another defendant in the original suit) and the Hocking Valley, concerning the shares they respectively held (see also 203 Fed. at pp. 305, 306). As respects the contract so made between the Hocking Valley and its trustee (Central Trust Company), it is there stated (Findings, sub. *b* of par. 10) that all these shares "with others" were pledged to the trustee as collateral security for bonds issued under the first consolidated mortgage of the Hocking Valley and Buckeye companies. The other shares so alluded to appear by the same contract to be the shares of stock now in question and at that time to have belonged to the Hocking Valley. By the terms of the contract the shares were sold to the trustee subject to the lien of the first consolidated mortgage and "to the rights of the bondholders thereunder" (see, in addition to par.

10 of Findings, Exhibit E to bill in the original suit). The execution of this contract is admitted by paragraph XIV of the Hocking Valley answer.

Further, it sufficiently appears from the plan formed as early as June, 1915, for placing the coal interests of the railroads under control of a single company, that the securities now in dispute were never intended to be transferred to that company. The portion of the plan here applicable follows:

"First. Organize a corporation under the laws of the State of New Jersey * * * with a capital stock of $4,000,000 * * *.

"Fourth. In order to permit the joint management of all the properties of the coal companies by one company, thus saving operating expenses and investment for equipment, by some one or more of the companies, the new company would lease the property of the Buckeye Coal & Railway Company, the Ohio Land & Railway Company * * *" (Vol. 5, Exhibit 17).

The evidence in the original suit shows that this plan was carried out, although we do not find copies of the leases in the record in that suit. It appears distinctly that the property of the Buckeye Company was leased to the Sunday Creek Company July 1, 1905; that the Sunday Creek Company holds the properties of both the Buckeye and the Ohio Land & Railway companies *under leases;* but in one of these showings only the unmined acreage is given, which does not correspond with the surface acreage admittedly embraced in the two leases; this is however cleared up by a letter of the president of the Sunday Creek Company, bearing date October 29, 1906, showing that the surface acreage substantially agrees with the acreage claimed under the present petition of the Sunday Creek Company. The existence of the leases and their dates as of July 1, 1905, appear in a mort-

gage which the Sunday Creek Company executed and delivered after the order confirming the sale of the stock to Mr. Jones was entered; this mortgage was presented with an application to the court for its action thereon, and reference to this subject will be made later; it is stated in the mortgage that both leases are of record in the counties in which the leased lands are situated.

Now, in spite of the relief sought through the present intervention, the facts deducible from the present petition of the Sunday Creek Company and the answer thereto of the Central Trust Company accord with the facts we have thus pointed out from the record of the original suit. It is alleged in the petition of the Sunday Creek Company, that the Hocking Valley "acquired ownership of all the stock of the said Buckeye Coal & Railway Company and still retains such ownership"; that "all the capital stock of said Ohio Land & Railway Company and all the bonds so issued by it as aforesaid, passed into the ownership of the Hocking Railway Company * * *"; that "the Hocking Railway Company still remains owner of all the capital stock of said Ohio Land & Railway Company and of its bonds issued as aforesaid * * *"; and that the Hocking Valley placed all of its stock in the Buckeye Company and in the Ohio Land & Railway Company, as well as all the bonds issued by the latter company, with the mortgage trustee named in the $20,000,000 mortgage, as additional security for payment of the bonds covered by that mortgage. These allegations are virtually admitted by the present answer of the Central Trust Company. This answer in substance alleges, and it is nowhere denied, that as early as March 1, 1899, the Hocking Valley "conveyed" to the Central Trust Company the shares of stock in the Buckeye Company "upon the trust set forth" in the first consolidated ($20,000,000) mortgage, and that all the capital stock of the Hocking Valley in the Ohio Land & Railway Company, and the bonds is-

sued by that company ($1,200,000 par value, but it is admitted that the true amount is $1,337,000), were deposited with the Central Trust Company as additional security for payment of such first-mortgage bonds. It is further alleged in the answer, and not denied, that $16,044,000 face value of these first-mortgage bonds are still outstanding.

Any consideration of the facts above set out will inevitably show that the stocks and bonds in dispute were not, and also why they were not, turned over to the Sunday Creek Company. It was never intended that they should be. According to the original plan, the management of the coal properties now in question was to be placed in that company through leases, not through transfers of the lessor companies' capital stock or bonds; and the plan so devised was carried into execution. The stocks and bonds are held by the Central Trust Company in pledge, and the Hocking Valley has at most only an equity in them. Whatever this interest is, or whatever its value may be, it is perfectly clear that it never became an asset of the Sunday Creek Company, and so could not have been embraced in the sale of the capital stock of that company; and to hold that the interest was nevertheless included in the sale, would in effect be to sanction the confiscation of property. It is equally clear that so long as the Sunday Creek Company shall pay the royalties or rents reserved, and otherwise keep its covenants, under the leases, its ownership of these stocks and bonds is not necessary to its exclusive possession and control of the leased coal properties.

The decree, then, as it stands in the original suit, would seem now, as it did at the time it was entered, to afford complete and independent control of these leased coal properties, if the lessee should keep its covenants. It is to be remembered that in granting leave to the Government, April 18, 1913, to amend its bill of complaint by

adding new parties defendant, it was stated among other things in the court's order:

> "* * * and it appearing to the court that all persons interested in the title to the stock of the Sunday Creek Company, and all persons holding any property pledged to secure the performance of the contract for dividing the coal traffic of the Kanawha and Hocking and the Continental Coal & Coke companies—as described in the opinion on file—are proper parties defendant; but that persons interested only in the title to the property of the Sunday Creek or its constituent companies, are not proper parties defendant".

The Buckeye and the Ohio Land & Railway companies being lessors, were not made parties, nor were they necessary parties. It does not follow, however, that the Hocking Valley should be permitted to retain the interests which seem to have brought about the present controversy. It in substance is alleged and denied that the present dispute has resulted alike in the withholding of payment for fuel coal purchased of the Sunday Creek Company by the Hocking Valley, and of royalties accruing under the two leases mentioned; it is practically conceded that the two coal companies are claiming forfeiture of the two leases by reason of such default in payment of royalties; and whatever may be the truth concerning such mutual withholding of payment, the obvious consequences of such a condition plainly call for an absolute sale of the interests of the Hocking Valley. Whether, burdened as these stocks and bonds are by the pledge, such a sale would have been ordered upon application presented at or before entry of the final decree, need not now be considered; certainly it was not suggested that such a condition as now seems to exist, might arise; and it must be conceded that such a condition was not foreseen by the court.

Appendix B.

UNITED STATES.	Commissioners of Johnson County *v.* Thayer, 94 U. S. 631, 643; First National Bank *v.* Salem Flour Mills Co., 31 Fed. 580; Lowe *v.* Pioneer Threshing Co., 70 Fed. 646; Hamer *v.* Taylor Rice Engineering Co., 84 Fed. 392; *In re* S. P. Lumber Co., 132 Fed. 618; 140 Fed. 988; Burnes *v.* Burnes, 132 Fed. 485; *In re* Castle Braid Co., 145 Fed. 224; Allen *v.* Sugar Co., 193 Fed. 825; *In re* Tichenor Grand Co., 203 Fed. 720; *In re* Fechheimer Fishel Co., 252 Fed. 357.
NEW YORK.	City Bank of Columbus *v.* Bruce, 17 N. Y. 507; Joseph *v.* Raff, 82 App. Div. 46, affd. 176 N. Y. 611; Hartley *v.* Pioneer Iron Works, 181 N. Y. 73; Moses *v.* Soule, 118 N. Y. Supp. 410; Richards *v.* Weiner, 145 App. Div. 353, affd. 207 N. Y. 65.
MASSACHUSETTS.	New England Trust Co. *v.* Abbott, 162 Mass. 153; Leonard *v.* Draper, 187 Mass. 536.
ILLINOIS.	Chicago P. & S. Co. *v.* Marseiles, 84 Ill. 643; Frazer *v.* Ritchie, 8 Ill. App. 554; Clapp *v.* Peterson, 104 Ill. 26; Commercial National Bank *v.* Burch, 141 Ill. 519; Rousch *v.* Illinois Oil Co., 180 Ill. App. 346; Olmsted *v.* Vance, 196 Ill. 243.
CONNECTICUT.	Crandall *v.* Lincoln, 52 Conn. 73; Buck *v.* Ross, 68 Conn. 29.
MICHIGAN.	Clark *v.* E. C. Clark Machine Co., 151 Mich. 416; Cole *v.* Cole Realty Co., 169 Mich. 247.

WISCONSIN.	Shoemaker *v.* Washburn Lumber Co., 97 Wis. 585; Marvin *v.* Anderson, 111 Wis. 387; Gilchrist *v.* Highfield, 140 Wis. 476; Atlanta & Walworth B. & C. Assn. *v.* Smith, 141 Wis. 377.
MINNESOTA.	State *v.* Minnesota Threshing Co., 14 Minn. 213; Brown *v.* St. Paul Plough Works, 62 Minn. 90; Ray *v.* Litchfield, 64 Minn. 306.
TEXAS.	Howe Grain & Mercantile Co. *v.* Jones, 21 Tex. Civ. App. 198; San Antonio Hardware Co. *v.* Sanger, 151 S. W. 1104.
NEW JERSEY.	Chapman *v.* Ironclad Rheostat Co., 62 N. J. L. 497; Berger *v.* U. S. Steel Corp., 63 N. J. Eq. 809.
GEORGIA.	Hartridge *v.* Rockwell, R. M. Charlton's Rep. 260; Robinson *v.* Beall, 26 Ga. 17; Fitzpatrick *v.* McGregor, 133 Ga. 332; Dalton Grocery Co. *v.* Blanton, 8 Ga. App. 809.
NEBRASKA.	Fremont Carriage Co. *v.* Thomsen, 65 Neb. 370; Forrest *v.* Nebraska Hardware Co., 132 N. W. 839.
IOWA.	Iowa Lumber Co. *v.* Forster, 49 Iowa 25; West *v.* Averill Grocery Co., 109 Iowa, 408; Lumber Co. *v.* Telephone Co., 127 Iowa, 351.

Appendix C.

READING IRON COMPANY

BALANCE SHEET

December 31, 1920

ASSETS		
Property Account		
Real Estate, Plant and Equipment	$7,760,686.64	
Office Furniture	26,761.17	
	$7,787,447.81	
Reserves for Depreciation, Depletion, etc	1,317,963.94	$6,469,483.87
Current Assets		
Cash	$265,840.54	
Notes Receivable	164,013.49	
Accounts Receivable	1,378,641.36	
Inventories	9,160,841.70	10,969,337.09
Investments		
Bonds, Stocks and Mortgages	$9,425,268.50	
Insurance Fund	39,420.13	9,464,688.63
TOTAL		$26,903,509.59
LIABILITIES		
Capital Stock		$1,000,000.00
Current Liabilities		
Notes Payable	$2,500,000.00	
Wages Accrued	465,250.00	
Wages Unclaimed	3.352.71	
Balance of Special Dividend 6/30/20	250,000.00	
Regular Dividend due Dec. 31, 1920	30,000.00	
Accounts Payable	1,748,094.62	
Installments a/c Emp. Sub. Liberty Bonds	315.95	4,997,013.29
Reserves		
Reserve for Self-Insurance	$39,420.13	
Reserve for Cash Discount on Sales	17,602.77	
Reserve for Bad Debts	9,172.54	66,195.44
Profit and Loss		
Balance Jan. 1, 1920	$21,791,553.78	
Loss Year 1920	141,252.91	
	$21,650,300.87	
Dividends	810,000.00	20,840,300.87
TOTAL		$26,903,509.59

4/21/21

IN THE

Supreme Court of the United States.

Nos. 609-610. **October Term, 1921.**

CONTINENTAL INSURANCE COMPANY and FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,

Appellants.

v.

READING COMPANY, et al.,

Appellees.

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee, Etc.,

Appellants,

v.

READING COMPANY, et al.,

Appellees.

Appeal From the United States District Court for the Eastern District of Pennsylvania.

Brief for William B. Kurtz and Madge Fulton Kurtz, Holders of Preferred Stock, Appellees.

THOMAS RAEBURN WHITE,

Counsel for William B. Kurtz and Madge Fulton Kurtz, Appellees.

International, 336 Chestnut St., Philadelphia.

INDEX.

CASES CITED.

AUTHORITIES CITED.

STATUTES CITED.

IN THE

Supreme Court of the United States.

October Term, 1921. Nos. 609-610.

CONTINENTAL INSURANCE COMPANY AND FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,

Appellants,

v.

READING COMPANY, ET AL.,

Appellees.

SEWARD PROSSER, MORTIMER N. BUCKNER AND JOHN H. MASON, AS A COMMITTEE, ETC.,

Appellants,

v.

READING COMPANY, ET AL.,

Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR WILLIAM B. KURTZ AND MADGE FULTON KURTZ, HOLDERS OF PREFERRED STOCK, APPELLEES.

Appellants object to the plan approved by the Court below on the ground that the proposed sale or distribution of stock of the Coal Company to both preferred and common stockholders of the Reading Company violates the rights of the common stockholders.

They base their argument upon two contentions:

(1) That the necessary effect of the sale of the stock of the Coal Company, under the plan, to the stockholders of the Reading Company, is to distribute to them something of value which must be construed to be a dividend resulting in a diminution of the surplus of the Reading Company;

(2) That the surplus of the Reading Company belongs to the common stockholders exclusively and, therefore, that the distribution aforesaid cannot lawfully include the preferred stockholders but must be confined to the common stockholders alone.

Both of these positions are untenable. The sale or distribution of the stock of the Coal Company takes place pursuant to dissolution and liquidation of the Reading Company and not by way of the distribution of a dividend. And further, even if this distribution should be construed to be a dividend out of surplus it could not be paid to the common stockholders alone under any theory of the contract between the company and its stockholders.

The position of these appellees may be stated in three propositions, as follows:

1. The sale and distribution of the stock of the Coal Company to the stockholders of the Reading Company is made pursuant to the dissolution and liquidation of the Reading Company.

2. The preferred stock is subject to no limitation in the distribution of assets in case of dissolution or liquidation, but shares equally with the common stock.

3. The surplus of the Reading Company cannot under any circumstances be distributed in dividends to the common stock to the exclusion of the preferred

stock; consequently, even if the process of distributing the stock of the Coal Company should be deemed the payment of a dividend from surplus, it could not be distributed to the common stock alone.

These propositions will be discussed in order.

First.

The Sale and Distribution of the Stock of the Coal Company to the Stockholders of the Reading Company is Made Pursuant to the Dissolution and Liquidation of the Reading Company.

A consideration of the essential features of the organization of the Reading Company, its condemnation by this Court as illegal, the separation decreed by this Court to be made, and the plan under which this separation is to be brought about, should remove any doubt as to the essential nature of what is proposed to be done. It is a dissolution of the Reading Company, involving not merely the termination of the enterprise in which capital was originally embarked in 1896, but the complete disappearance of the corporate entity which now exists.

The last reorganization of the Reading properties took place in the year 1896 (Trans., pp. 213, *et seq.*). An old charter was made use of but for purposes of this discussion the situation is the same as if the Reading Company was then organized. To it were conveyed the various Reading properties mentioned in the plan of reorganization. Omitting details, these properties consisted of two business enterprises, *viz.:* (1) a transportation business, involving the ownership and operation of the Philadelphia & Reading Railway and its allied lines, and (2) a coal business involving the ownership and operation of extensive anthracite coal lands, collieries and equipment.

It is true, as alleged in the briefs of appellants, that the Reading Company was essentially a holding, not an operating, company. It owned certain railway equipment and owned all the stock of the Philadelphia & Reading Railway Company and all the stock of the Philadelphia & Reading Coal & Iron Company, as well as other securities, but it did not operate any of the properties. The object of this method of organization, however, was to control through one corporate entity the coal business and the transportation business in such manner as to result in a profit to the stockholders of the Reading Company; its effect was to violate the statutes of the United States, as this Court has found.

At that time this method of organization was believed to be legal, as is shown by the opinion of twelve of the leading lawyers of the United States (Trans., p. 251), and the public, including many of the present stockholders, invested money in the securities of the Reading Company, in view of the fact that the enterprise in which it was engaged offered unusual opportunities for profit by reason of the combination of the transportation business and the coal business.

The Court has now decreed that the combination of these two businesses under the circumstances shown by the evidence was illegal and has directed that the two shall be separated. In other words, that the business in which the stockholders invested their money can be carried on no longer.

What is the effect of this decree so far as regards the business enterprise in which the stockholders originally invested their money? Certainly it is brought to an end and the capital which was originally embarked in it should be returned to its owners, *viz.*, the stockholders of the Reading Company. This is recognized by the company and the plan provides for it. The first

step in this process is the distribution of the coal stock to such owners and the plan proposes that it shall be distributed in such a way that ultimately it will be entirely separated from the Reading Company or any of its stockholders. We refer to this as a distribution, not because we disagree with any contention to the contrary which may be made by other appellees, but in order that we may meet the argument of appellants on the ground they have chosen. That this distribution is pursuant to the dissolution and liquidation of the Reading Company is not open to doubt. The dissolution of a corporation in the sense in which the word is used in this connection means the termination of the business enterprise in which the money of the stockholders was invested and the distribution of the corporate assets to the owners thereof. It does not necessarily mean a technical dissolution of the corporate entity, although that also will follow in this case under the plan approved by the Court below.

It is not necessary to determine whether the stockholders would have a legal right to demand dissolution when the business in which their money was invested ceased to exist: It may be they would have. At any rate it cannot be questioned that they could legitimately object to being compelled to continue their investment in a business different from that in which they originally embarked their capital, and most certainly it cannot be doubted that the corporation can with propriety recognize this right and provide voluntarily for a dissolution and liquidation of the company. This is what the corporation has done in proposing the plan which the Court below approved.

Carefully prepared with the idea of interfering as little as possible with the immense business operations of the Reading Company, it proposes first that the stock representing the coal business shall be distributed

to the stockholders of the Reading Company, thus giving them a more direct interest in one of the two principal enterprises in which their capital was invested.

The plan might have provided for the distribution in a similar manner of the other stocks and securities held in the treasury of the Reading Company, but in order to disturb as little as possible the great business interests involved, it proposes that, instead of distributing such securities directly to the stockholders, the Reading Company shall merge with it the Philadelphia & Reading Railway Company, thereby vesting in a new consolidated company ownership of the property and securities belonging to both companies, including the railway properties and equipment. By this means the present stockholders of the Reading Company will acquire as direct an interest in the Philadelphia & Reading Railway as they would acquire if the stock of that company were distributed to them directly. The process is essentially the same—instead of giving them the stock of the corporation which owns the railway, the corporation of which they already own the stock merges into a new company, which becomes the owner of the railway and their stock becomes the stock of the consolidated company.

This merger will take place pursuant to authority contained in the charter of the Reading Company, which provides (Act of April 7, 1870, Sec. 4, Trans., p. 193), that the company (now the Reading Company) shall have power "to merge or consolidate, or unite with the said company (Reading Company) the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon."

The merger thus authorized will necessarily be brought about according to the method prescribed by the Act of the Commonwealth of Pennsylvania, approved May 3, 1909, P. L. 408.

This would necessarily be the fact in any case, as there is no other method provided by law whereby such a merger can take place. The said Act of 1909, however, must necessarily be invoked to supply authority for the Philadelphia & Reading Railway Company to enter into the proposed merger. The Philadelphia & Reading Railway Company was incorporated pursuant to the terms of the Pennsylvania Act of May 31, 1887, P. L. 278, which provides in effect that, upon a reorganization of, *inter alia,* a railroad, a new corporation may be formed by a reorganization committee, which shall have the same powers as the old corporation. By this means the Philadelphia & Reading Railway Company acquired all the powers of the old Philadelphia & Reading Railroad Company. (See opinion of counsel, Trans., p. 248.)

The Philadelphia & Reading Railroad Company was organized under the special Pennsylvania Act of April 4, 1833, P. L. 144. Neither this Act, nor any of its supplements, confers upon that company any independent right to merge with any other company; such right is, therefore, necessarily dependent upon general law, and the only applicable statute is the Act of 1909 above mentioned.

That the Philadelphia and Reading Railway Company could not enter into a merger or consolidation without statutory authority is plain.

Lauman v. The Lebanon Valley Railroad Co., 30 Pa. 42; 72 Am. Dec. 685;

in which the Supreme Court of Pennsylvania said regarding a proposed merger:

> "No one will deny that, without the authority of the legislature, neither of these companies has power to enter into such a contract; for, as corporations, their powers are strictly limited to the province marked out for them in their charters."

Clearwater v. Meredith, 68 U. S. (1 Wall.) 25; 17 L. Ed. 604;

in which this Court said, referring to a power to merge (p. 39):

> "The power of the legislature to confer such authority cannot be questioned, and without the authority, railroad corporations organized separately, could not merge and consolidate their interests."

While there are Acts of the Pennsylvania Assembly relating to the merger of railroad corporations, they are confined to the merger of companies owning connecting lines. As the Reading Company owns no lines of railway, these Acts are not applicable. The Act of 1909, *supra*, is therefore the only Act of Assembly which would permit the Philadelphia & Reading Railway Company to merge with the Reading Company or any other company except a railroad owning a connecting line, and, therefore, the merger must be made according to the terms of that Act. The method whereby the merger will be brought about is as follows:

A formal agreement between the Reading Company and the Philadelphia & Reading Railway Company, must be executed, setting forth the terms and conditions of the merger, the name of the new corporation, the names of the directors and officers, the nature of the stock issues of the new corporation, the manner of converting the capital stock of the old corporation into the new, etc. The merger must thereupon be approved by the stockholders of each corporation. Thereafter the agreement must be filed in the office of the Secretary of the Commonwealth and, when approved by the Governor, the new corporation will come into existence under the terms and with the powers specified in the agreement of consolidation. It is necessary that new letters patent

shall be issued by the Governor to the consolidated corporation, and thereupon the property of both companies shall become vested in the consolidated corporation, upon the terms specified in said act. The act provides on this point, as amended by the Act of April 29, 1915, P. L. 205:

> "Such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent."

It has been expressly held by the Superior Court of Pennsylvania that a merger under the said Act of 1909 has the effect of destroying the corporate identity of all merging companies.

In the case of *Pennsylvania Utilities Co. v. Public Service Commission,* 69 Pa. Superior Ct. 612, the Court, in discussing the said Act of 1909, used the following language:

> "It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: Railroad Co. v. Georgia, 98 U. S. 359-362; Pullman Palace Car Co. v. Missouri Pacific Railroad Co., 115 U. S. 587-594; 7 R. C. L., Sections 144, 145, 146, 147, and the many authorities there cited."

The effect of a merger or consolidation, having particular reference to the question whether the merging corporations are dissolved is fully discussed in *Clearwater v. Meredith,* 68 U. S. (1 Wall.) 25; 17 L. Ed. 604; *Central Railroad Co. v. Georgia,* 98 U. S. 359; 25 L. Ed. 185; and *Yazoo & Mississippi Valley Ry. Co. v. Adams,* 180 U. S. 1; 45 L. Ed. 395; 21 Sup. Ct. 240. It may be that there are cases where one corporation may be merged into another in such a manner as to continue one of the merging companies in existence, but this can only be in cases where the statutes clearly authorize it and the prescribed method of consolidation permits it.

The cases above cited and many others referred to therein clearly show that the question whether the consolidation of two corporations results in their dissolution depends upon a construction of the statutes permitting the consolidation. Where the consolidation or merger under the terms of a statute necessarily results in a consolidated company with different powers and responsibilities from the constituent companies, and particularly if under the statutes it appears that a new franchise is to be conferred, the act of consolidation or merger is held to dissolve all of the merging companies.

In such case it does not matter that the name of the consolidated company may be the same name as one of the constituent companies, nor does it matter that the consolidated company will issue no new stock, but that the stock of one of the constituent companies will become the stock of the new company.

Yazoo & Mississippi Valley Ry. Co. v. Adams, 180 U. S. 1, *supra.* (See especially pp. 18 and 19.)

This case is the latest one in this court in which this question is extensively examined. In the course of the proceedings it became relevant and necessary

to determine whether the consolidation of the Memphis & Vicksburg Railroad Company with the Yazoo & Mississippi Valley Railway Company resulted in a dissolution of both companies and the formation of a new company. The Memphis & Vicksburg Road was authorized to consolidate with any other company whatever on any terms which it might agree upon with such other company. The Yazoo & Mississippi Valley Railway Company was in the same manner authorized to consolidate, and the consolidated company was to have and enjoy all the property and franchises of the previously existing companies. Under the agreement of consolidation which these companies entered into it was expressly provided that the corporate organization of the Yazoo & Mississippi Valley Railway Company should not be disturbed, and that if the same were legal the act of consolidation should not be construed to establish a new company; the name was to remain the same, Yazoo & Mississippi Valley Railway Company, and existing stockholders of the Yazoo Company were to retain their stock.

This Court held that upon a proper construction of the statutes, notwithstanding the terms of the contract of consolidation, it must be held that the effect thereof was to create a new corporation of the same name as one of the consolidating corporations. (See especially pp. 18 and 19.)

The discussion of the Court in this case, as in the others mentioned, clearly indicates that the question in all such cases will turn upon a proper construction of the statutes under which the consolidation takes place.

Whatever may be argued with regard to the power to merge or consolidate contained in the charter of the Reading Company, there can be no doubt that any consolidation which takes place under the

terms of the Act of 1909 necessarily must result in a new corporation to which new letters patent must be issued by the express terms of the statute. A mere reading of the statute makes this so plain that no argument is needed.

Other cases generally sustaining the proposition that a consolidation under circumstances similar to these results in a dissolution of both consolidating companies are as follows:

Shields v. Ohio, 95 U. S. 319; 24 L. Ed. 357;
St. Louis, etc., Ry. Co. v. Berry, 113 U. S. 465; 28 L. Ed. 1055; 5 Sup. Ct. 529;
Keokuk & Western R. Co. v. Missouri, 152 U. S. 301; 38 L. Ed. 450; 14 Sup. Ct. 592.

The result of the plan as a whole, therefore, will be that the assets of the Reading Company will have been distributed *pro rata* to the stockholders of Reading Company share and share alike, either through the sale and distribution of the coal stock or through the method of vesting in a new company all of the existing assets of both the Reading Company and the Philadelphia & Reading Railway Company, whereby existing stockholders of the Reading Company acquire a more direct interest in those properties. The fact that the Reading stockholders do not exchange their stock certificates for other certificates is immaterial. The stock which they own after the consolidation will be stock in a different company with powers and responsibilities different from the existing Reading Company.

It is said that the Reading Company will continue to exist. This is not correct. There will be, after the plan has been put completely in operation, a company known as the "Reading Company," but it will not be the Reading Company that now exists; the fact that it

has the same name has been held to be an unimportant detail. It will be a new and entirely different corporation for which new letters patent must issue; it will be a common carrier; it will own a railway; it will have surrendered many of the powers now possessed and enjoyed by the Reading Company, and will possess others; it will be subject to the Constitution of Pennsylvania and to the respective Federal or State acts controlling common carriers or other public service companies. How can it be contended that the Reading Company continues to exist?

What, then, is the conclusion? What has happened? Clearly the following: The business in which the capital of the stockholder was invested has been held to be unlawful and has been dissolved by decree of this court; the assets constituting that business have been distributed to the stockholders in one form or another; the corporation itself has disappeared and ceased to exist, and another corporation of the same name has taken its place. If this is not a dissolution what is a dissolution?

There can be no doubt that when the plan has been put into effect the dissolution of the Reading Company will be final and complete.

The only question to be determined, therefore, is what are the rights of the stockholders in case of such dissolution, and this brings us to the second question.

Second.

The Preferred Stock is Subject to No Limitation in the Distribution of Assets in Case of Dissolution or Liquidation, But Shares Equally With the Common Stock.

It is correctly argued in the briefs filed on behalf of appellants that the respective rights of the preferred and common stockholders of this company de-

pend upon their contracts, as set forth in the stoc certificates.

The contracts between the Reading Company an its stockholders show beyond possibility of questio that in case of liquidation all classes of stock are e titled to share equally in the division of the assets the company.

The material parts of the certificates of first pr ferred, second preferred and common stock appea hereinafter at p. 25.

An examination of these contracts discloses tha they are entirely silent regarding the rights of an class of stockholders to participate in the division assets in case of liquidation.

In the absence of statutory, charter or contra provisions to the contrary, preferred stock share equally with common stock in the distribution of asse upon dissolution.

Cook on Corporations, Section 278;
14 *Corpus Juris*, 422, Section 580;
Fletcher Cyclopedia Corporations, Sectio 3640;
Sternbergh v. Brock, 225 Pa. 279; 74 At 166; 133 Am. St. Rep. 877; 24 L. R. A (N. S.) 1078;
Englander v. Osborne, 261 Pa. 366; 104 At 614; 6 A. L. R. 800;
Birch v. Cropper, L. R., 14 App. Cas. 525;
Hale v. Cheshire Railroad, 161 Mass. 44 37 N. E. 307;
Jones v. Railroad, 67 N. H. 119; 38 Atl. 12
Jones v. Railroad, 67 N. H. 234; 30 Atl. 61 68 Am. St. Rep. 650;
Lloyd v. Penna. Electric Vehicle Co., 75 N. Eq. 263; 72 Atl. 16; 138 Am. St. Re 557; 21 L. R. A. (N. S.) 228; 20 An Cas. 119;

Gordon's Ex'rs. v. R., F. & P. R. R. Co., 78 Va. 501;

Drewry-Hughes Co. v. Throckmorton, 120 Va. 859; 92 S. E. 818.

In *Cook on Corporations*, Seventh Edition, Section 278, the rule is stated as follows:

> Upon the dissolution of a corporation, and the distribution of its assets among the stockholders after the payment of the corporate indebtedness, it is the settled rule of law that, in the absence of any provision in the statutes, by-laws, certificate of stock, or contract under which the preferred stock was issued, to the contrary, preferred stockholders have no priority over common stockholders. Their stock was preferred in respect of dividends, and not in reference to the capital stock. The assets of the corporation are to be distributed as though the preferred stock had been common stock. The preferred stockholder in the distribution becomes a common stockholder.

And in a note to Section 269:

> There is nothing in the word "preferred" which restricts or cuts down the rights which at common law are inherent in all stock. It is settled law that upon dissolution the preferred stock shares *pro rata* with the common stock, in the distribution of the assets after payment of debts, even though such assets are in excess of the par value of both kinds of stock.

In *Englander v. Osborne*, 261 Pa. 366, *supra*, the Court used the following language (p. 369):

> The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock.

Birch v. Cropper, L. R., 14 App. Cas. 525, *supra,* is the leading English case on the subject. This case involved the winding up of the Bridgewater Navigation Company and it appeared that the assets of the company were sufficient not only to pay the debts and the amount invested by the preferred and common stockholders, but to leave a large surplus for distribution. The common stockholders insisted that the whole of this surplus was profits, and that, as they were entitled to all of the profits after paying the five per cent. to the preferred stockholders, they were entitled to the whole of the fund. The Court held that this position was untenable, and that the rule contended for by the common stockholders applied only to annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect the decree was affirmed by the House of Lords. Lord Macnaghten said (p. 546):

> The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders, liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company.

In *Jones v. Railroad,* 67 N. H. 234, *supra,* a bill in equity was brought against the defendant railroad for an injunction to restrain the company from permitting preferred stockholders to subscribe to their proportionate share of newly authorized capital. The bill was dismissed. Replying to an argument of plaintiff the Court said:

> The answer to the plaintiff's contention is readily seen when we inquire as to the meaning of the word "dividends," as used in the charter-contract. "The agreement that class one shall be entitled to six per cent. 'dividends from net earnings . . . and shall never be entitled to greater dividends,' and that 'classes two and three shall not be entitled to dividends from any source except that resulting from a saving of interest,' is a restriction of the described earnings and savings, and not of the right to dividends of capital." Jones v. Railroad, *supra;* Cook Stock and Stockh., s. 278.

In *Drewry-Hughes Co. v. Throckmorton,* 120 Va. 859, *supra,* a case involving the rights of preferred stockholders, the Court used the following language (pp. 866, 867):

> "After liquidation commences, preferred stockholders and common stockholders are, in the eyes of the law, upon the same plane, both being mere stockholders, excepting in so far as their participation in the assets of the company had been agreed upon between them."

The briefs filed on behalf of appellants misapprehend the nature of the contracts of the Reading Company with its stockholders. One-half of the stock of the company is referred to as preferred stock, but it is not preferred stock in the sense in which that word is commonly used. It does confer upon the holders of it a preferecne in the matter of distribution

of dividends from the current earnings of a particular fiscal year, but it confers no preference whatever in connection with the distribution of assets in case of liquidation.

As has been pointed out in the briefs of appellants, the future of the Reading Companies at the time of the reorganization in 1896 was problematical, and indeed doubtful, in view of their history. It is argued that the holders of preferred stock were given a position of greater security for a return of their investment than the holders of the common stock. This contention is without merit. The preferred stockholders received no preference in the distribution of assets, but took their chances with the common stock. If the operations of the company had been disastrous, so that its assets were depleted and liquidation resulted, the preferred stock would have received *pro rata* the same as and no more than the common stock.

Even regardless of the principle of law above referred to, that any stock, no matter what class, represents co-ownership of the company unless otherwise provided, it would seem in equity and good conscience that if investors in the preferred stock are subject to the hazards of the business, the same as investors in the common stock, they should participate in accretions of assets if the business is profitable.

It is difficult to ascertain from the appellants' briefs exactly what position they do take on this question. They do not argue that the preferred stock, in case of liquidation, is not entitled to share equally with the common stock, and inferentially at least this appears to be admitted, in view of the arguments in both briefs that the proceedings now under consideration do not involve a liquidation. Indeed, in the Walker brief it is substantially admitted that in case of liquidation the stock would share equally, where it is said

(p. 20): "The position of these appellants is that, at least *so long as the Reading Company continues to exist and function,* all of its surplus . . . belongs to the common stockholders," after payment of four per cent. dividends on the preferred stock.

Reference is made, however, at various points in appellants' briefs to the fact that there is reserved in the stock certificates a right to redeem the preferred stock at par, at the option of the company. It is nowhere argued, for it cannot reasonably be so argued in the absence of any such limitation, that the preferred stock is limited to par in the distribution of assets, but the references to the right of redemption seem to indicate that some such thought is in the mind of counsel.

But this reserved right has no bearing on the question under discussion. It is only an option, has not been exercised and under existing circumstances could not be exercised.

Whether it could legally be exercised after a dissolution and liquidation has been decreed with the effect of depriving the preferred stock of its rightful share of assets owned by the company need not now be considered. That question will be met if it ever arises.

Appellants devote a large part of their briefs to arguing that the four per cent. limitation of dividends contained in the preferred stock certificates is not only a limitation of the preference, but a limitation of the amount of dividends which preferred stockholders are entitled to receive.

It has not been contended at any stage of the case that the preferred stockholders are entitled to current annual dividends in excess of four per cent. Appellants, however, argue as if it were contended by appellees that the preferred stock is not limited to four per cent. dividends, and as if the question at

issue depended upon such a contention. They further argue that the Pennsylvania rule, as laid down in the cases which have been cited by both sides, regarding the construction of preferred stock certificates, is in conflict with certain cases which they cite from other States. The Pennsylvania rule referred to is that, where stock certificates provide for the payment to preferred stockholders of dividends at a certain rate, in preference to any payment upon common stock, but do not expressly provide that the preferred stock shall receive no further dividends, the limitation is construed to be not of the dividends, but only of the preference. Therefore, after the common stock has received the same amount as the preferred, the latter is entitled to share equally with the common.

Fidelity Trust Co. v. Lehigh Valley R. R. Co., 215 Pa. 610; 64 Atl. 829; 7 Ann. Cas. 613;

Sternbergh v. Brock, 225 Pa. 279; 74 Atl. 166; 133 Am. St. Rep. 877; 24 L. R. A. (N. S.) 1078;

Sterling v. H. F. Watson Co., 241 Pa. 105; 88 Atl. 297;

Englander v. Osborne, 261 Pa. 366; 104 Atl. 614; 6 A. L. R. 800.

It may be conceded that there are some cases, which on this point hold the contrary view, *viz.*, that where a preferred stock certificate expressly provides for the payment of dividends to preferred stock at a specified rate, in preference to dividends on the common stock, this, in the absence of any contrary provisions in the certificate, is to be treated as a limitation of the dividends as well as the preference.

This difference of opinion, however, as to the inferences to be drawn from the presence or absence of such provisions in a stock certificate, has nothing to

do with the case before the court There is no decision which has been cited by appellants, or which exits so far as we know, which questions the rule that if a preferred stock certificate gives to the holders of preferred stock no preference and provides no limitation in case of dissolution, there is no limitation of the rights of the preferred stock to share in the assets.

The phraseology of the argument of appellants would seem to warrant the inference that they ask the Court to look upon the cases they cite as authority for the contrary proposition. But clearly they are not. The cases relied upon in both briefs are:

Stone v. U. S. Envelope Co., 119 Maine 394; 111 Atl. 536;
Russell v. American Gas & Electric Co., 152 App. Div. (N. Y.) 136;
Equitable Life Assurance Society v. Union Pacific R. R. Co., 212 N. Y. 360.

These cases are not authority for the proposition that preferred stock is to be limited to its par value in the distribution of assets, merely because it is limited in dividends or because it is not expressly provided that it shall not be limited to its par value. In two of them the preferred stock was expressly limited to its par value in case of dissolution, and in the third it was held to share equally with the common stock.

In *Stone v. U. S. Envelope Co.*, 119 Maine 394, it was expressly provided that the preferred stock was limited to par in the distribution of assets. The Court said (p. 397):

> "The parties by a contract embodied in the by-laws have provided for the preferred stockholders a seven per cent preferential dividend *and in case of liquidation one hundred per cent.* This excludes other participation." (Italics ours.)

In *Russell v. American Gas & Electric Co.*, 152 App. Div. (N. Y.) 136, the provision was thus stated by the Court (p. 137):

> "The preferred stock is entitled to cumulative dividends at the rate of six per cent per annum and to preference in the distribution of assets *until the par value and accumulated dividends have been paid and 'to no further dividend or distribution.'* " (Italics ours.)

In *Equitable Life Assurance Society v. Union Pacific R. R. Co.*, 212 N. Y. 360, the Court, at page 367, expressly disclaimed any intention to make any rule regarding the distribution of any accretion or increment of capital of a going corporation which had become a part of the permanent capital of the company. The Court did, however, in passing, say (p. 366):

> "If, on the other hand, all or part of the gains which it is proposed to distribute are accretions to and have somehow become permanent capital and been withdrawn from availability for dividends it will be assumed that they must be distributed amongst all the stockholders."

It is, therefore, apparent that in this case the Court, while finding that the preferred stockholders were not entitled by reason of the provisions of the contract to dividends in excess of four per cent., nevertheless assumed that in case of distribution of assets they would have been entitled to share equally with the common stock.

These cases, therefore, are clearly not authority against the position assumed by appellees in this case, which is that, in the absence of any provision in the contract giving the preferred stock a preference in the distribution of assets or limiting it to its par value in case of such dissolution, all classes of stock are entitled to share equally.

One other point remains to be noticed. It is argued in the briefs filed on behalf of the appellants, and correctly argued, that if a construction of a contract such as this, widely circulated among investors, has been adopted and for years has gone unchallenged, it should be given weight by the Court as a contemporaneous practical construction of the contract. In 1904, nearly eighteen years ago, an application was made to list the preferred stocks of the Reading Company on the New York Stock Exchange. In this application a statement was made as follows (Trans., p. 181):

> "The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets."

This public declaration unquestionably came to the knowledge of brokers and others dealing with securities, and received very wide publicity. So far as the record appears, and in fact, there had been no dissent or objection thereto from that time until the present, although the statement has been repeated both in writing and orally many times. There is no doubt that the preferred stock has been commonly understood, not only by the Reading Company, which signed the application to list the preferred stocks on the New York Stock Exchange, but by brokers dealing in the stock and by the public generally to have a right to share equally with the common in case of dissolution. While this, of course, is not conclusive, it should have weight as indicating a contemporaneous practical construction by the parties to the contract.

The above considerations make it clear that the preferred and common stocks are entitled to share equally in case of dissolution, and inasmuch as the distribution now under consideration is made in pur-

suance of a dissolution, all classes of stock are entitled to share equally.

It may be added that if anyone has the right to complain of the plan of dissolution, it is the preferred and not the common stockholders. The preferred stockholders could legitimately object to being compelled to continue their investment in the new consolidated Reading Company, which now becomes exclusively a railway operating company, subject to the limitation of four per cent. from current earnings. If they continue as stockholders of the new Reading Company, they can reasonably demand to be placed on the same basis as the common stock. Preferred stockholders, however, have by their general approval of the plan expressed a willingness for the sake of a prompt adjustment of these matters, to continue their investment in the Reading Company as a four per cent. preferred stock, provided they are given their proper share in the distribution of the coal stock. Of this, the common stockholders have no right to complain.

Third.

The Surplus of the Reading Company Cannot Under Any Circumstances be Distributed in Dividends to the Common Stock to the Exclusion of the Preferred Stock; Consequently, Even if the Process of Distributing the Stock of the Coal Company Should be Deemed the Payment of a Dividend From Surplus, it Could Not be Distributed to the Common Stock Alone.

In order to succeed in this appeal appellants must convince the Court of the soundness of two propositions, (1) that the distribution under consideration constitutes not a distribution of assets in liquidation, but a dividend declared and paid out of surplus; (2) that if a dividend be declared and paid out of surplus

it must go to the common stock alone, and that none of it can lawfully be distributed to the holders of preferred stock.

It has already been demonstrated that the first proposition is erroneous; the second also is without legal basis on which to rest. Even if the distribution should be considered to be a dividend declared and paid out of surplus by an operating company, it could not be paid to the common stock alone.

An examination of the contracts between the Reading Company and its various classes of stockholders makes this clear; dividends on the common stock cannot be paid out of "undivided net profits remaining from previous years," constituting the surplus, but only out of earnings of the preceding fiscal year in which the full dividends on the preferred stock have been paid out of the earnings of that year. The material parts of the certificates of the three classes of stock are as follows:

FIRST PREFERRED STOCK.

"The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. If from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular

fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

"Such First Preferred Stock is authorized to the amount of twenty-eight million dollars, and the consent of the holders of a majority of the whole amount of such First Preferred Stock then outstanding, given at a meeting of the Stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, as well as to the creation of any mortgage additional to that for $135,000,000 heretofore authorized, except that, at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased, without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; and accordingly, this certificate is issued and accepted upon condition that, without further consent from the holder or owner hereof, the Reading Company may so increase and issue its First Preferred Stock.

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law."

SECOND PREFERRED STOCK.

"The Second Preferred Stock is entitled to non-cumulative dividends, at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any

payment in or for such fiscal year of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock.

"Such Second Preferred Stock is authorized to the amount of forty-two million dollars; and, except as hereinafter stated, the consent of the holders of a majority of the whole amount of such Second Preferred Stock then outstanding, given at a meeting of the stockholders called for that purpose, is necessary to any increase of such authorized amount thereof, or of the First Preferred Stock, as well as to the creation of any mortgage additional to the mortgage of $135,000,000 heretofore authorized.

"The Reading Company reserves the right, and this certificate is issued and accepted upon condition that at any time after dividends at the rate of four per cent. per annum shall have been paid for two successive years on the First Preferred stock, the Reading Company, without further consent from the holder or owner hereof, may exercise the right to convert the Second Preferred

Stock, not exceeding $42,000,000 at par, one-half into First Preferred Stock and one-half into Common Stock, and accordingly may so increase and issue its First Preferred Stock and its Common Stock to provide for such conversion of the Second Preferred Stock.

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

"The Second Preferred Stock is subject to the prior rights of holders of First Preferred Stock at any time outstanding, according to the preferences thereof."

COMMON STOCK.

"First Preferred Stock has been authorized to the amount of twenty-eight million dollars, and Second Preferred Stock to the amount of forty-two million dollars; and a Mortgage has been authorized to the amount of $135,000,000 and the consent of the holders of at least a majority of such part of the Common Stock as shall be represented at a meeting of stockholders called for that purpose is necessary to any increase of such authorized amount of First Preferred Stock or Second Preferred Stock, as well as to the creation of any additional mortgage; provided, that without further consent, at any time after dividends at the rate of four per cent. per annum shall have been paid on the First Preferred Stock, for two successive years, the Second Preferred Stock, not exceeding $42,000,000, may be converted at par, one-half into First Preferred Stock and one-half into Common Stock, and that for such purpose and to such extent the Reading Company may increase and issue its First Preferred Stock and its Common Stock.

"The Reading Company shall have the right at any time to redeem either or both classes of its Preferred Stock, at par in cash, if such redemption shall then be allowed by law.

"The Common Stock is subject to the prior rights of holders of all classes of Preferred Stock at any time outstanding, according to the preferences thereof.

"If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years, after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

There are certain conclusions readily apparent from examining these contracts, which may be stated thus:

(1) In case of liquidation, the holders of preferred stock have no preference in the distribution of assets and are not limited to the par value of the stock held by them.

This has already been discussed.

(2) The preferred stock is entitled to four per cent. non-cumulative dividends out of the earnings of any fiscal year in preference to any dividends upon the common stock from the earnings of that year.

In view of the contemporaneous practical construction of this contract, as pointed out in the briefs of appellants, it may be assumed, although under the decisions of *Fidelity Trust Co. v. Lehigh Valley R. R. Co.*, 215 Pa. 610; 64 Atl. 829; 7 Ann. Cas. 613; *Sternbergh v. Brock*, 225 Pa. 279; 74 Atl. 166; 133 Am. St.

Rep. 877; 24 L. R. A. (N. S.) 1078; *Sterling v. H. F. Watson Co.*, 241 Pa. 105; 88 Atl. 297; and *Englander v. Osborne*, 261 Pa. 366; 104 Atl. 614; 6 A. L. R. 800 it would otherwise be very doubtful, that the four per cent. dividend specified in the stock certificates is a limitation not only of the preference, but of the dividends which the preferred stockholders may receive out of the earnings of such year.

The stock certificates, however, contain certain provisions regarding the sources from which such dividends may be paid which are most important in this connection. They may be stated thus:

(3) Such dividends to holders of preferred stock may be paid from the accumulated earnings or, in other words, from the surplus of the Reading Company.

(4) Such dividends to common stockholders may not be paid from accumulated earnings of previous years, but may be paid only from surplus earnings of *the* previous fiscal year, *after* the full dividends for that year to the preferred stockholders have been paid *out of the earnings of that year.*

These last two propositions appear from a careful analysis of this contract.

The source of dividends on the preferred stock is thus stated in the first preferred stock certificate (italics ours).

> "The first preferred stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment in or for such fiscal year of any dividend on other stock; *but only from undivided net profits of the company* when and as determined by the board of directors, and only if and when

the board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the first preferred stock, there shall remain any *surplus undivided net profits,* the board out of such surplus may declare and pay dividends for such year upon the second preferred stock."

It will be observed that the source of dividends on the preferred stock is described in this certificate in two places as "undivided net profits" of the company. There can be no doubt under this language that dividends on the preferred stock can be declared out of surplus, under the general principles applicable in such cases. This, however, is made more clearly evident by the provisions relating to the source of dividends on the common stock, which very certainly and in markedly different terms describe the source of such dividends as being confined to surplus earnings of a particular year.

These provisions as to the common stock are as follows (italics ours):

"If, from the business of any particular fiscal year, *excluding undivided net profits remaining from previous years,* after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, *and out of such surplus net profits of such year may pay,* dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

It is thus seen to be most carefully provided that dividends on common stock must come exclusively

from the business of a particular fiscal year "exclud ing undivided net profits remaining from previou years," and after the dividends on the preferred stoc have not only been declared, but paid for that year *ou of the net profits of that year.* In other words, n dividend can be declared upon common stock out o the earnings of any year in which the directors hav been compelled to resort to the surplus in order t pay dividends on the preferred stock.

These provisions are unusual but, it is submitted upon a careful analysis of the contract, unquestion able, and upon reflection it is readily understood wh the contract contained such terms.

The dividends payable to the preferred stock wer non-cumulative, and, therefore, in order to make th stock valuable, it was necessary to adopt some pla to make it reasonably certain that its dividends woul be regularly paid. This guarantee of such regula payment is found in the provisions above quoted Every year after payment of dividends there woul naturally be surplus earnings going into general sur plus which year by year would thus be built up. I subsequently the earnings of the company shoul diminish, dividends on preferred stock might still b paid so long as any undivided net profits remaine from previous years.

In order, however, to preserve this surplus fo the purpose of making more certain the payment o dividends on the preferred stock, it was very carefully provided that the surplus consisting of "undivided net profits remaining from previous years" could not be diminished under any circumstances by the pay ment of dividends on common stock, and that in any year in which the surplus had been reduced by paying dividends on preferred stock, no dividends whatever on common stock could be paid.

This arrangement was a reasonable one and was intended to place the preferred stock on a better basis than an ordinary non-cumulative stock, with no such restrictions as to dividends on common stock.

The clear intent of the contracts was to provide that the directors of the Reading Company should at the close of each fiscal year determine what the profits of that year would justify by way of dividends; and if there were sufficient net earnings in that particular year to pay dividends on both first and second preferred stock, to permit the payment of a dividend also on the common stock; thereafter, or in either case, the surplus remaining was to go automatically and at once into the general surplus, where, as constituting "undivided net profits remaining from previous years," it was out of the reach of the directors so far as regards dividends on the common stock alone, being expressly excluded as a source of dividends on such stock; it was, however, subject to call in case of deficiency in current earnings to pay dividends on preferred stock.

In order to make more certain the protection of the preferred stock, the sentence last above quoted was inserted, reading:

> "But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

The peculiar wording of the sentence last above quoted is made the basis of a contention that the directors could under some circumstances declare dividends out of surplus, owing to the expression "any previous fiscal year." It is argued that by prohibiting the payment of dividends on common stock out of the net profits of any previous fiscal year, in which the full

dividends had *not* been paid on the preferred stock, it was intended to permit the payment of such dividends on common stock out of the accumulated earnings of all previous years in which the full dividends *had* been paid upon the preferred stock and thus to free the surplus for this purpose. This view of the contract, however, is inadmissible. The sentence in prohibitory form was clearly intended to re-enforce the sentence immediately preceding it, which was positive in character, and it is quite apparent that the reference to "any previous fiscal year" means any fiscal year out of the earnings of which dividends were then being declared or were under consideration. If it did not mean this, it would directly contradict all that had gone before and by mere inference would place at the disposal of the directors in declaring dividends on common stock "undivided net profits remaining from previous years," which, under the terms of the contract, are expressly excluded.

It is so clearly provided elsewhere that dividends on common stock can be paid only out of the profits of a particular fiscal year, excluding undivided profits from previous years that unless the contract be deemed to contradict itself we are bound to interpret "previous fiscal year" in this conection as meaning any previous fiscal year for which dividends on all classes of stock are about to be declared, and it clearly does mean this.

The practice of the Reading Company conforms to this construction. The declaration and payment of dividends are made at or after the close of the fiscal year, and out of the earnings of that year. Consequently, the reference to any "previous fiscal year" was proper, for it is necessarily a *previous* fiscal year from whose earnings the final determination as to the amount of dividends is made.

It appears from the minutes of the meeting of the Board of Directors held in December, 1920, that in that month provision was made for the payment during the succeeding year, from and out of the earnings of the fiscal year then about to close, of the full dividends on the first and second preferred stock (Trans., p. 94). It further appears that no dividends on common stock were declared until after provision had been made and the cash set aside for the payment of the full dividends in 1921 on the preferred stock. It will be noted that all the dividends paid in the year 1921, both on preferred and common stock, were (and necessarily were, for the contract so requires) paid out of the earnings of the fiscal year 1920. Further, dividends on the common stock could not be declared out of the earnings of the fiscal year 1920 until after the cash had actually been set aside for payment of the full dividends on the preferred stock, which to comply strictly with the sentence now under discussion was done "in" that year or 1920. This makes perfectly clear the language of the certificate under discussion. Dividends on common stock are always paid out of the earnings of a *previous* fiscal year. The only purpose, therefore, of the sentence under discussion was to re-enforce the provision earlier contained in the contract, that no dividends could be paid on the common stock, out of the earnings of "any previous fiscal year," unless full dividends on the preferred stock had in fact been paid "in" that year.

This is a clear and consistent meaning for the sentence under discussion. It is in harmony with the foregoing portions of the contract and it must, therefore, be adopted as the true construction; certainly, it must be accepted as against the construction contended for by appellants, which would make the sentence now under consideration contradictory of the earlier provisions in the same contract.

It is argued by appellants that the directors of th company, having declared a dividend on the commo stock, out of the surplus earnings of a particular fisca year, in which the full dividends on the first and secon preferred stock had been paid, may in later years re peat the process in such way as to finally exhaust th surplus.

This argument entirely ignores the words "ex cluding undivided net profits remaining from previou years," which distinctly limit the source from whic such dividends on common stock can be declared, t the net profits of the particular fiscal year in question These words certainly mean something and no mean ing has been or reasonably can be suggested othe than that they were intended to prevent the very thing which appellants argue may be done, namely, the dis tribution of accumulated earnings from previous years as dividends on the common stock alone. It is not easy to see how words could more plainly prohibit such a distribution.

It would be unreasonable to carefully prevent the directors from declaring dividends on common stock out of "undivided net profits remaining from previous years," and to prevent them from paying any divi dends whatever on common stock in any year in which the surplus had been reduced by the payment of divi dends on the preferred stock, and at the same time permit them in their discretion to distribute the entire surplus among the common stockholders. Such a con struction would render meaningless the very careful provisions in these certificates for the protection of the preferred stockholders.

It may then be inquired whether the surplus must be maintained indefinitely as a source out of which dividends may be paid on the preferred stock alone, or whether it may be distributed to all classes of stock alike.

It clearly must be one or the other, for in declaring dividends on the common stock alone "undivided net profits remaining from previous years" must be excluded, which necessarily eliminates the contention made by counsel for the common stockholders that the surplus could be distributed exclusively to that class of stock.

We think the most reasonable view to take is that the surplus is in the same position as capital assets, so far as regards any right to distribute the same. It is probable that the preferred stockholders could insist upon a reasonable surplus remaining to guarantee the payment of their dividends in case the net earnings of the company should at any time be insufficient. But it seems unreasonable to require a very large surplus, accumulated either from earnings or from accretions of capital assets, to be maintained indefinitely, and we are inclined to the opinion that it may, within the reasonable discretion of the directors, be distributed to all classes of stock alike.

It is, however, unnecessary to discuss further the question as to what could be done with the surplus, if the Reading Company were to continue in operation. It is plain that it could not be distributed to the common stock alone, and this is a complete answer to the argument which appellants advance. It is equally clear that a legal objection to its distribution, even in such a case, could be made only by the preferred stockholders, and they have made no objection.

It necessarily follows from the considerations above discussed that:

(1) The sale and distribution of the coal stock to the stockholders of the Reading Company is one step in the process of the dissolution of the Reading Company and the distribution of its assets, pursuant to

the terms of the plan, which has been approved by the Court below and meets the approval of the great majority of all classes of stock.

(2) All classes of stock of the Reading Company are entitled to share equally in the distribution of assets in case of dissolution.

(3) Even if the distribution of the coal stock should be construed to be a dividend declared out of surplus by a company in full operation, it could not be paid to the common stock to the exclusion of the preferred stock, because by the terms of the contracts between the company and its stockholders, dividends to common stockholders cannot be paid out of surplus constituting undivided net profits remaining from previous years.

The appeals should, therefore, be dismissed, and the action of the Court below should be affirmed.

T. R. WHITE,
Counsel for William B. Kurtz and Madge Fulton Kurtz, Appellees.

IN THE

Supreme Court of the United States

October Term, 1921, Nos. ~~608, 609~~ 609-610

CONTINENTAL INSURANCE COMPANY, *et al.*, *Appellants*,

vs.

READING COMPANY, *et al.*, *Appellees*.

SEWARD PROSSER, *et al.*, as a Committee, etc., *Appellants*,

vs.

READING COMPANY, *et al.*, *Appellees*.

BRIEF ON BEHALF OF ADRIAN ISELIN *ET AL.*, AS A COMMITTEE REPRESENTING CERTAIN FIRST AND SECOND PREFERRED STOCKHOLDERS, APPELLEES.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,
Counsel for Adrian Iselin et al., Appellees.

Synopsis of Argument.

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BRIEF ON BEHALF OF ADRIAN ISELIN ET AL., AS A COMMITTEE REPRESENTING CERTAIN FIRST AND SECOND PREFERRED STOCKHOLDERS, APPELLEES.

Statement.

On the previous appeal in this case, this Court held (253 U. S., 26) that the scheme of reorganization of the Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company adopted December 14, 1895, "combined and delivered into the complete control of the board of directors of the Holding Company," *i. e.*, the Reading Company, "all of the property of much the largest single coal company operating in the Schuylkill anthracite field and almost one thousand miles of railway over which its coal must find its access to interstate

markets," and that this constituted a combination unduly to restrain interstate commerce within the meaning of the Act (253 U. S., p. 48).

> "The Reading Railway Company and the Reading Coal Company each had thereafter but one stockholder—the Holding Company—and their earnings were to be distributed, not in proportion to the shares of their capital stocks, aggregating $28,000,000, but were to go to the creditors and shareholders of the Holding Company, with its mortgage debt of $135,000,000 and its capital stock of $140,000,000. The Holding Company thus served to pool the property, the activities and the profits of the three companies" (*ib.*, p. 48; Rec., p. 9).

The Court then noted the use which was made by the combination of the powers secured through the holding company, and held:

> "For flagrant violation of the first and second sections of the Anti-Trust Act, the relations between the Reading Company, the Reading Railway Company and the Reading Coal Company and between these companies and the Central Railroad Company of New Jersey must be so dissolved as to give to each of them a position in all respects independent and free from stock or other control of either of the other corporations" (253 U. S., 59, 60; Rec., p. 21).

Finally, the Court concluded as follows:

> "It results that * * * as to the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company and the Central Railroad Company of New Jersey, the decree of the District Court will be reversed and the cause remanded with directions to enter a decree in conformity with this opinion, dissolving the combination of the Read-

ing Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various Companies held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company * * *" (pp. 63-64; Rec., p. 24).

After this decision, the Reading Company moved this Court to modify the decree to be entered on the decision, by authorizing the District Court to consider and approve or reject petitioner's plan "for a form of decree which would permit of the holding by the Reading Company of the stock of either the Philadelphia and Reading Coal and Iron Company or the Philadelphia and Reading Railway Company, provided the Reading Company had disabled itself from exercising any influence upon the conduct of the business of the other of the said Companies and of the Lehigh and Wilkes-Barre Coal Company and the Central Railroad Company of New Jersey * * *."

The Government opposed this motion, upon the ground that

> "the District Court under such a modification would clearly be authorized to consider, not only plans for the retention by Reading Company of one of its subsidiaries, but also what arrangements short of an actual *disposition* of the stocks, bonds and property of the other controlled Com-

panies would *disenable* the Reading Company from 'exercising any influence upon the conduct of either businesses.'"

The motion was denied by this Court without opinion (253 U. S., 478).

The decree of this Court, therefore, in effect was, that the Reading Company should no longer be permitted to hold the stock of either the Philadelphia and Reading Railway Company, or the Philadelphia and Reading Coal and Iron Company, or the other corporations mentioned in the decree, and the decree on the mandate from this Court entered in the District Court, accordingly required the defendants to submit to that Court

> "a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various Companies, held by the Reading Company as may be necessary to establish the entire independence from that company and from each other of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, to the end that the affairs of all those now combined companies may be conducted in harmony with the law" (Rec., pp. 36, 37).

THE REQUIREMENT TO STRIP THE READING COMPANY OF ALL OF ITS INTERESTS IN THE FOUR OTHER CORPORATIONS NAMED, WAS, IN EFFECT, A DECREE OF LIQUIDATION, FOR THOSE INTERESTS CONSTITUTED SUBSTANTIALLY ALL OF ITS PROPERTY.

The Plan formulated by the Reading Company to

comply with such decree (Rec., p. 40), and the modified Plan finally approved by the District Court (Rec., pp. 274, 287, *et seq.*), required the Reading Company, first, to divest itself of all interest in the Coal Company, and then to merge itself with the Philadelphia and Reading Railway Company, the Reading Company agreeing to accept the Pennsylvania Constitution of 1874, and to surrender all of the powers conferred by its existing charter which are inappropriate to a railroad corporation of Pennsylvania, and thus

> "the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier, and the relation of the Reading Company, as a specially chartered holding company, to the Philadelphia and Reading Railway Company will be terminated" (Rec., p. 277).

Other provisions of the Plan and the decree provided for the separation of the stocks of the other Companies —the Central Railroad Company of New Jersey, the Lehigh and Wilkes-Barre Coal Company, etc.

This virtual dissolution of the Reading Company, involving the distribution of substantially all of its assets and the merger of its identity with that of the Philadelphia & Reading Railway Company under a changed corporate status, although retaining the same name, in effect terminates the existence of the present Reading Company, provides for a distribution of substantially all its assets and their distribution to (1) a new consolidated or merged railroad corporation and (2) a new corporation to hold the beneficial interest in the Coal properties.

By this Plan, the Reading Company agrees to assume the $96,524,000 General Mortgage Four Per Cent. Bonds which are the joint obligations of itself and the Coal & Iron Company, and to secure which all the capital

stock of the Coal & Iron Company is pledged, and to save that Company and its assets harmless therefrom, and at or before the maturity of said bonds, to obtain the release of the Coal Company's properties from the lien of the General Mortgage and the discharge of the Coal & Iron Company from liability on said bonds.

The Coal & Iron Company will pay to the Reading Company, $10,000,000 in cash or current assets and $25,000,000 in its 4 per cent. mortgage bonds maturing the same date as the said General Mortgage Bonds. The Reading Company and the Coal & Iron Company shall release each other from all claims and liabilities of either against the other, including a claim of approximately $70,000,000 carried on the books of the Reading Company as an asset and on the books of the Coal & Iron Company as a liability.

The Reading Company is then to sell, assign and transfer, subject to the lien of the General Mortgage, all of its interest in the stock of the Coal & Iron Company, including its present right to vote and receive dividends thereon, to a new corporation, to be formed with appropriate powers, which shall become a party to this cause and be subject to the decree herein, in consideration of the payment by such new corporation to the Reading Company of $5,600,000, and the agreement of the new corporation to issue and offer its shares to the stockholders of the Reading Company as hereinafter stated. The said new company will issue 1,400,000 shares of stock without par value and will offer the same to the stockholders of the Reading Company, preferred and common, share and share alike, for $2.00 for each share of Reading stock. Provision shall be made for the disposition of any rights to subscribe which may not be availed of by the Reading stockholders, within a fixed period, to the end that the new corporation may receive the full purchase price of $5,600,000.

The stock of the new corporation, in the first instance, is to be issued to a trustee appointed by the Court, who shall issue certificates of interest which the Reading Company shall offer for subscription to its stockholders, preferred and common, share and share alike; but provisions are made so that no person can actually acquire by purchase or otherwise the right to hold and enjoy the stock represented by such certificates without proof that he does not own any stock in the Reading Company and in making the purchase is not acting for or on behalf of any stockholder of said Company or in its interest (Rec., pp. 294, 304-307).

The Reading Company is then to merge with the Philadelphia and Reading Railway Company (all of whose stock it owns) under the authority of the present charter of the Reading Company (Rec., p. 193), so far as that Company is concerned and under authority of the Act of the Pennsylvania Legislature, hereinafter referred to (p. 28), so far as the Philadelphia and Reading Railroad is concerned, and subect the railway property to the direct lien of the General Mortgage. It will then accept the Pennsylvania Constitution of 1874 and will surrender all the powers it possesses under its present charter which are inappropriate to a railroad corporation of Pennsylvania. Thus the coal properties and business will be completely separated from the railroad properties and business, while the stockholders of the present Company, which owns both, will receive their appropriate pro rata share of each, safeguarded against future control of both in the same hands by the provisions above referred to.

There are various other provisions in the plan, but sufficient is here given for the consideration of the only question presented on these appeals.

The Appellants are respectively two Insurance Companies and a Committee representing certain shares of Common Stock of the Reading Company. They

objected in the District Court to so much of the plan as provided for the offer to the preferred and common stockholders of the Reading Company, share and share alike, of certificates of interest in the new corporation to which is to be transferred the interest of the Reading Company in the capital stock of the Philadelphia & Reading Coal & Iron Company, claiming that such offer in effect constitutes a distribution of accumulated net profits of the Reading Company to which the common stock alone is entitled. This contention having been denied by the District Court, they bring this appeal.

These Appellees are a Committee representing the holders of 89,611 shares of First Preferred Stock and 117,786 shares of Second Preferred Stock of Reading Company, who were permitted by the District Court to intervene and be heard in the protection of their interests (Rec., p. 131).

ARGUMENT.

I.

The sale of the beneficial interests in the Coal Company stock is a convenient method of accomplishing the required dissolution of an unlawful combination.

The sale by Reading Company to the new corporation of all its interests in the Coal & Iron Company for $5,600,000 and the agreement to issue 1,400,000 shares of non-par stock and to offer the same pro rata to the preferred and common stockholders of Reading Company for $2.00 per share of said company, is a convenient method of distribution to the Reading stockholders of whatever value there may be in the holdings of Reading Company in the Coal & Iron Company, over and above $5,600,000, while insuring a disposition of that Company

free from any control by the Reading (Railroad) Company or its stockholders. It is an incident to the dissolution of the unlawful combination of the railroad and coal mining properties decreed by this Court.

The Appellants contend that the certificates of interest offered for sale are worth more than the price at which they are offered to the Reading stockholders and therefore that the company in effect is distributing a part of its surplus assets to and among its stockholders pro rata, whereas after the First and Second Preferred Stock has received 4 per cent. per annum, all surplus profits belong to the common stockholders.

II.

The distribution of interests in the stock of the Coal & Iron Company complained of is not a dividend of net profits of the Reading Company within the meaning of the contract between that Company and its shareholders, embodied in the stock certificates, and in respect of which the preferred stockholders are entitled and limited to 4 per cent. dividends, in preference and priority to any dividend to the common stock out of such net profits arising in any fiscal year.

On the contrary, the distribution is of the capital assets of the Reading Company, made pursuant to a decree of dissolution and in the liquidation of its affairs, in which liquidation all classes of stockholders are entitled to share alike without preference or priority of any one class over any other.

The holders of the preferred stock of the Reading Company are entitled to the same rights in the corporation as the common stockholders, save only insofar as respects the distribution of the net profits arising from

the business of the Company in any particular fiscal year, and in that the Second Preferred Stock might be converted, one-half into First Preferred and one-half into Common Stock, and in that all the preferred stock is subject to redemption at par, at the option of the corporation.

The Reading Company was created by special act of the Legislature of Pennsylvania, passed May 24, 1871 (Rec., p. 189), under the name of Excelsior Enterprise Company, which act conferred upon it the same rights, powers, privileges, franchises and immunities as had been conferred upon the Pennsylvania Company by the special act creating it and supplements thereto. By Section 4 of the Pennsylvania act, the corporation was empowered "to make from time to time dividends from the profits made by said Company."

Its capital stock was fixed at $100,000, with the privilege of increasing the same by a vote of the holders of a majority of the stock present at any annual or special meeting, and it was provided that

> "should the capital stock at any time be increased, the stockholders, at the time of such increase, shall be entitled to a *pro rata* share of such increase, upon the payment of the instalments thereon duly called for * * *" (Rec., p. 194).

It was further provided,

> "That the capital stock of said company as authorized by said act, or the stock thereof when increased in the mode and manner prescribed therein, may be in the whole common, or in part preferred stock, as the said company may from time to time determine; and the said company are hereby authorized and empowered to issue said stock, or any portion thereof, in payment of any debt or liability incurred in the purchase of any property, or they may sell or dispose of any portion of said common or preferred stock, on such terms and conditions as the Company may agree upon with any

party or parties, company or companies, or in the doing of any other act authorized by the provisions of the act to which this is a supplement." (Rec., pp. 194, 196.)

Pursuant to the authority so granted, in 1896, the capital stock of the Reading Company was increased from $100,000 to $140,000,000, divided into 2,800,000 shares of the par value of $50 each of which $28,000,000 should be first preferred, $42,000,000 second preferred stock, and $70,000,000 common stock (Rec., p. 78). It was further provided that the first preferred stock should be entitled to non-cumulative dividends

> "at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, *in preference and priority to any payment in or for such fiscal year,* of any dividend on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom. If, after providing for the payment of full dividends for any fiscal year on the First Preferred Stock, there shall remain any surplus undivided net profits, the Board out of such surplus may declare and pay dividends for such year upon the Second Preferred Stock. *If, from the business of any particular fiscal year, excluding undivided net profits remaining from previous years,* after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company. But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock" (Rec., p. 82). (*Italics ours.*)

It was further provided that the consent of the holders of a majority of the whole amount of the first preferred stock then outstanding, given at a meeting of the stockholders called for that purpose, should be necessary to any increase of the authorized amount thereof, as well as to the creation of any mortgage additional to that for $135,000,000, to be issued in accordance with the provisions of the reorganization plan,

> "except that at any time after dividends at the rate of four per cent. per annum shall have been paid thereon for two successive years, said First Preferred Stock may be increased without such consent, to the extent of 420,000 shares for use towards the conversion of the Second Preferred Stock; * * *" (Rec., p. 83).

The Reading Company was also given the right at any time to redeem either or both classes of its preferred stock at par in cash, "if such redemption shall then be allowed by law." The Reading Company further reserved the right at any time after dividends at the rate of 4 per cent. per annum shall have been paid for two successive years on the first preferred stock, to convert the second preferred stock, not exceeding $42,000,000 at par, one-half into first preferred stock and one-half into common stock, and accordingly to so increase and issue its first preferred and common stock to provide for such conversion (Rec., pp. 78-81). Certificates were directed to be issued from time to time for such first preferred, second preferred and common stock, and the forms adopted are given in the record (pp. 82-87).

The Reading Company never did exercise either (a) the right reserved to convert the second preferred stock into one-half first preferred and one-half common, or (b) the right to redeem either or both classes of its preferred stock at par in cash. All of the stock, first pre-

ferred, second preferred and common (except an original issue of 1,000 shares for cash), as well as about $56,000,000 of the General Mortgage Four Per Cent. Bonds, were issued in consideration of the transfer by the purchasers at the foreclosure sale in 1895, to the Reading Company, of all of the capital stock of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company, the bonds of the Philadelphia & Reading Railway Company for $20,000,000, certain railway equipment and terminals, and stocks and bonds of other companies controlling certain railroads (Rec., p. 219). The Reading Company and the Philadelphia & Reading Coal & Iron Company jointly executed a mortgage to the Central Trust Company of New York, as Trustee, to secure their joint and several General Mortgage Four Per Cent. Bonds, authorized to be issued up to a total amount of $135,000,000, of which $50,369,000 were issued at once as part consideration for property conveyed pursuant to the plan of reorganization, and there was pledged as security for the said mortgage, among other things, the entire capital stock of the Philadelphia & Reading Coal & Iron Company and certain other stocks, bonds and other property.

III.

The relations between the holders of preferred stock and the Corporation is a contract relation and the extent of their right to share in the corporate profits and of their preference over the common stockholders, and in distribution of capital in liquidation, depends upon the terms of their contract.

See cases cited in 6 Fletcher Cyc. Corp., Section 3751.

Where, as in the instant case, neither the act of incorporation, nor the applicable laws, define the rights of the respective classes of shareholders, but merely authorize the corporation to issue preferred and common stock and to fix the terms and conditions which shall constitute the rights of the holders, the provisions of the certificates constitute the contract between the holders and the corporation, and their rights must be determined by such contract, read in the light of the established law of Pennsylvania.

As the Circuit Court of Appeals in the Second Circuit said in *Niles* v. *Ludlow Valve Co.*, 202 Fed., 141, 143, respecting a question as to the relative rights of preferred and common stockholders of a New Jersey corporation,

> "It seems evident that the rights of the respective stockholders must be measured by the certificate of incorporation and the law of New Jersey in force when the defendant was organized."

IV.

The holders of common stock in Reading Company have no right to exclude the preferred stock from sharing in the distribution of surplus earnings not distributed by the Board of Directors in any fiscal year, but carried to Profit and Loss, or Surplus Account.

Under the provisions of the stock certificates above quoted, the net earnings of the Company in each fiscal year are to be dealt with separate and distinct from those of previous years. No distribution by way of dividends can be made out of them to the common stock until a full 4 per cent. shall have been paid on the First and Second preferred stock. If there shall then remain any surplus net profits for such year, the Board of Directors "*may declare, and out of such surplus net profits of such year may pay, dividends upon any other stock of the Company*" (Rec., p. 82). To the extent that there are no such surplus profits, or none which the Board of Directors, in the exercise of a sound discretion, conclude shall be distributed, the right of the common stockholders to share in the surplus profits of such year is at an end.

> "So far as the holders of the common stock were concerned their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period."
>
> *Englander* v. *Osborne*, 261 Pa. St., 366, 369.

In *Englander* v. *Osborne*, 261 Pa. St., 366, the certificates of preferred stock of a corporation entitled the holders to receive, when and as declared,

> "a fixed yearly cumulative dividend of six per cent. payable quarterly, before any dividend shall be set apart on the common stock."

No dividends were paid by the Company upon their preferred or common stock during a period of nine years, after which a dividend of 54 per cent. covering the current year and all arrearages was declared and paid on the preferred stock, and, at the same time, a dividend of equal amount on the common. Plaintiff, a holder of preferred stock, sued to restrain the payment of the dividend to the common, claiming that such stock was not entitled to a dividend of more than 6 per cent. without sharing the excess equally with the preferred stockholders. In affirming a decree granting the injunction, the Supreme Court said:

> "The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock. When a dividend is declared the former are entitled to first claim to the extent of their preference for the current year and if there remains a sum more than sufficient to pay a similar dividend on the common stock, both classes of stockholders are entitled to share equally in the excess. In the absence of agreement, express or implied, that dividends shall be cumulative, unpaid dividends in the past cannot be claimed: 10 Cyc. 573.
>
> "Likewise there is no logical reason for holding that common stockholders are entitled to go back of the current year, and claim to be reimbursed for unearned dividends in past years. To do so would render such dividends cumulative in effect without agreement. Accordingly, when during previous years no dividends were earned this was conclusive as to the right of all stockholders, both preferred and common, except for the contractural right of the former to payment out of future profits to the extent of their preference, before the latter would be entitled to participate in the earnings. So far as the holders of the common stock were concerned

their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period: *Dent* v. *London Tramways Co.*, 16 Ch. Div., 344, 353; Morawetz on Corporations (2nd Ed.), Sec. 459, cited in 10 Cyc, 573."

THE PREFERRED SHAREHOLDERS ARE ENTITLED TO ALL THE RIGHTS AND PRIVILEGES OF THE HOLDERS OF OTHER CLASSES OF STOCK, EXCEPT IN SO FAR AS THE CONTRACT EXPRESSLY OR BY NECESSARY IMPLICATION PROVIDES OTHERWISE.

In *Fidelity Trust Co.* v. *Lehigh Valley R. R. Co.*, 215 Pa. St., 610, preferred stock was issued by defendant Company under provisions of law whereby such stock

> "was entitled to a preference over all other stock of said company in every future dividend of profits declared, until the holders were paid from the funds applicable to the payment of such dividend, ten per cent. per annum."

It was further enacted:

> "that the holders of all the other stock of the company should not be entitled to participate in any future dividend profits of the company until the holders of preferred stock had been first paid from the funds applicable to such dividend ten per cent. per annum (pp. 611-612).

In three particular years, the preference stock was paid a 10 per cent. dividend, and a like dividend was paid on the common stock, and an extra dividend was also divided equally between the preferred and common. After a series of years in which no dividends were paid the preference shareholders, a dividend of 10 per cent. was declared on the preferred stock and a dividend of 1 per cent. on the common stock. Upon a bill filed by the holders of the preferred stock praying for a decree declar-

ing them entitled to cumulative dividends at the rate of 10 per cent. per annum, before the payment of any dividends to the holders of common stock, relief was granted in accordance with the prayer. The question considered in the Supreme Court was whether or not the preferred stockholders should be charged, as against the amount in arrears during certain particular years when no dividends or less than 10 per cent. dividends were paid, with the amount of dividends paid to them in excess of 10 per cent. during certain other years. On this point, the Court said:

> "The preference created by the statute gave to the holders of the preferred stock, the right to receive $5.00 per share per annum on each share of stock held by them, before the other stockholders were entitled to anything. That was the extent of the preference. If the funds applicable to a dividend amounted to just enough for that purpose the other stockholders took nothing. But when each class of stock had been paid ten per cent., they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors, nor was the amount paid to them in excess of ten per cent. in any year to be charged to them as an advance payment upon any future dividends that might be earned or divided in coming years. There was no preference shown in the distribution of these extra dividends. All the shareholders fared alike insofar as they were concerned. The preference created under the act of assembly went only so far as to give to the preferred stockholders a right to claim the first proceeds out of the fund applicable to dividends, to the extent of $5.00 per share, per annum on their stock, and no farther. After that amount was paid, the common stockholders were entitled to participate, and did so participate, taking during the years when the extra dividends were paid, the same amount per share, as the preferred stockholders. So that the

extra payments during the years mentioned cannot be considered as overpayments to the holders of preferred stock. If the preferred stockholders had been limited, under the terms of the contract, to ten per cent per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound. But there is no such limitation in the act. The preferred stockholders stood upon the same plane as the others, with the additional advantage that they had the first right to partake in the distribution of profits up to the limit of $5.00 per share per annum, and if necessary, the whole amount of the profits might be taken for that purpose, even if thereby the other stockholders were excluded."

In *Sternbergh* v. *Brock*, 225 Pa. St., 279, preferred stock was issued under a provision that it should receive a cumulative yearly dividend of 5 per cent., payable in each year, before any dividends should be set apart or paid on the common stock, and to be paid in full, both principal and accrued dividends, in the event of liquidation or dissolution of the Company before any amount should be paid to the holders of the common or general stock. From the organization of the Company until the year 1907, the holders of the preferred stock were paid the stipulated 5 per cent. annual dividend and no more, while all profits above the amount so paid were distributed by dividends to the common stockholders. In March, 1907, a quarterly dividend of 2 per cent. was declared by the Directors upon all stock, both preferred and common, which was at the rate of 8 per cent. per annum. Plaintiff, the holder of common stock, brought suit, claiming that the preferred stockholders were not entitled to receive more than 5 per cent. per annum on the par of their stock. An injunction to prevent such pay-

ment was denied, and this decree affirmed in the Supreme Court, where POTTER, J., said (p. 286):

> "Where there is no stipulation in the contract to the contrary, the weight of authority clearly favors the right of preferred stockholders to share with the common stockholder in all profits distributed, after the latter have received an amount equal to the stipulated dividend on the preferred stock.
>
> "'*In the absence of special provisions, the holders of preferred stock in a corporation are in precisely the same position, both with respect to the corporation itself and with respect to creditors of the corporation, as the holders of common stock, except only that they are entitled to receive dividends on their shares, to the extent guaranteed or agreed upon, before any dividends can be paid to the holders of common stock*' 2 Clark and Marshall on Priv. Corp. (1901), Section 417-c." (Italics ours.)

In *Sterling* v. *Watson Co.*, 241 Pa. St., 105, the Court said:

> "The certificate is a contract between the parties and means exactly what it says. The preferred stock is cumulative and the semi-annual dividends are given preference out of net earnings. These dividends being made payable out of the net earnings at stated periods must necessarily be understood as payments in cash at the dividend periods. Any other construction would be in disregard of the every-day experience of business men and would do violence to the common understandnig of parties dealing in matters of this character. The dividend rate and the times of payment clearly indicate that the parties intended the preferred dividends to be paid in cash out of the net earnings and not in any other manner" (p. 110).

It was held in that case, that in exercising the right to retire preferred stock at par, reserved to the corpora-

tion in issuing the stock, the accumulated dividends at the specified rate must first be paid, and there could not be charged against the amount so due, the value of a stock dividend which had been declared by the corporation, a portion of which was distributed to the preferred stockholders. The Court held that the par value of such stock could not be regarded as a payment on account of the semi-annual dividends to which the preferred shareholders were entitled, and that there was nothing in the contract of the parties to warrant the payment of semi-annual dividends by the issue of new stock, and that, therefore, such dividends must be paid out of net earnings and not by stock.

V.

Capital assets acquired by the Corporation at the time of its organization, or by consolidation, or merger with other companies, do not constitute "net profits of the company" for "any particular fiscal year" with respect to which the preferred stockholders are entitled and restricted to a limited preference in dividends, within the meaning of the contract between the Reading Company and its stockholders.

In *Pardee* v. *Harwood Electric Co.*, 262 Pa., 68, an action by a preferred stockholder, to compel the payment of dividends, the certificate read as follows:

> "The holders of the preferred stock shall be entitled to receive cumulative dividends at the rate of six per cent. per annum, which must be declared by the board of directors, when earned, to the extent of and only from the undivided net earnings of the Harwood Electric Company remaining after the payment of all operating expenses and fixed charges, in each and every fiscal year and which shall be in preference and priority to any payment in or for such fiscal year, of any dividend on other stock."

The company by merger with other companies had, at the time of its formation, a surplus of several hundred thousand dollars. The Court refused to direct the payment of dividends from the surplus, saying (p. 73):

> "This surplus, which had existed from the time of the merger, could not be regarded as net earnings, or considered as such upon the question of dividends to the holders of preferred stock."

* * * * * * *

And on page 74:

> "The fact that certain balances are denominated in the books of a corporation as net earnings is, as against the corporation, persuasive but not conclusive evidence that they are such. In the absence of intervening rights, they are subject to explanation."

That the stockholders of the Reading Company acquired their stock with knowledge and understanding that the only disparity in right between the different classes of stock was respecting the distribution of net earnings, is demonstrated by the terms of the application made to the New York Stock Exchange for listing the stock of the Reading Company, in which it was said:

> "The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets" (Rec., p. 181).

This is but the statement of a well settled rule of law.

> *Lloyd* v. *Penn. El. Vehicle Co.*, 75 N. J. Eq. 263.

In *North American Mining Company* v. *Clark*, 40 Pa. 432, the Court said:

> "* * * the proprietors have made no express provision in their articles for winding up the concern, and therefore equity may define this process for them. But equality is equity, and we must adopt equality unless we have clear reason for doing otherwise, and we find none such. According to the express terms of the association, it seems to us that the new stockholders were to be at least equal sharers in the capital, and that they must have purchased on this supposition; and equity will not assume inequalities or preferences in such matters further than it finds them contracted for. The old stockholders have contracted for a preference out of the profit, but not out of the capital stock or basis of the operations of the company, and there is nothing revealed to us that satisfies that they ought to have it."

In *Lloyd* v. *Penn. El. Vehicle Co.*, 75 N. J. Eq., 263, a statute authorized the creation of two or more kinds of stock of such classes and with such designations, preferences and voting power or restriction or qualification thereof as might be stated in the certificate of incorporation, and a corporation organized thereunder provided that its preferred stock was "to receive and the company to pay a fixed yearly dividend of six per cent. before any dividend shall be set apart or paid on the general stock." Upon a winding up it was held that the preferred stockholders were entitled only to the preference set out in the certificate of incorporation and were not to be paid on account of the par value of their shares in preference to the common stockholders.

In *Guaranty Trust Co.* v. *Galveston City R. Co.*, 107 Fed., 311, at p. 318, the Circuit Court of Appeals for the Fifth Circuit, per TOULMIN, *J.*, said:

> "When a corporation is dissolved by consolidation with another, or becomes involved in debt and concludes to stop operations and pay its debts,

> if there are any assets left after paying off the debts they are ordinarily distributed between the stockholders in proportion to the number of shares which each holds. There is no preference of one stockholder over other stockholders, except such preference is expressly contracted for. A preference as to capital stock or a distribution of net assets may be expressly contracted for."

In *Hamlin* v. *Toledo, St. Louis & Kansas City Railroad Co.*, 78 Fed., 664, 672, Mr. Justice LURTON, then Circuit Judge, said:

> "Ordinarily preferred stock is entitled to no preference over other stock in relation to capital. But where there is an express agreement giving such a preference, not prohibited by local law nor the charter, we see no reason why it is not a valid contract, as between the corporation and such preferred stockholders, and binding upon the common stockholders."

This principle was quoted and applied in *Toledo, St. Louis & Kansas City R. Co.* v. *Continental Trust Co.*, 95 Fed., 497, 531—a case of dissolution by foreclosure and sale of entire corporate assets.

In *Roberts* v. *Roberts-Wicks Company*, 184 N. Y., 257, a corporation, because of an impairment of its capital, reduced its capital stock and as a result of the reduction there was a balance or surplus. The directors proceeded to devote this surplus to the payment of dividends and arrears thereof on its preferred stock. The certificate provided that the owners were entitled to an annual dividend of 6 per cent. payable out of the surplus profits of the Company before any dividend was payable on the common stock; that such dividend was cumulative and in case of non-payment should bear interest at the rate of 6 per cent. from the date when payable; that all remaining surplus profits of the company should belong

to the common stock and that in all other respects the preferred and common stock were alike. It was held that such surplus so resulting could not be devoted to the payment of dividends and arrears on the preferred stock, since dividends were payable out of net profits and the fund resulting from a reduction of the capital stock did not consist of profits, but of capital which belonged to all of the shareholders in proportion to their holdings.

Judge GRAY said (p. 266):

> "That which constitutes the capital stock of a corporation belongs to all of its stockholders, proportionately to their holdings. It is divided into shares and each share represents the holder's proportionate interest. (*Jermain* v. *L. S. & M. S. R. Co.*, 91 N. Y., 492.) Upon dissolution, or in liquidation, it entitles him to share ratably in the assets. If the directors had undertaken to divide this surplus of capital, it was apportionable, only, among all the stockholders ratably. * * * But, assuming that the directors in their discretionary management of the company's affairs, concluded, and were empowered, to distribute this surplus of capital, the preferred stockholders would have no legal, or equitable, claim upon it in satisfaction of past due and unpaid dividends. That was not the contract. Their only right would be to share in such a distribution ratably with the common stockholders. (*Strong* v. *Brooklyn C. T. R. R. Co.*, 93 N. Y., at p. 435.) The charter and the contract made them alike in all respects except as to dividends. * * * In the present case, it must be borne in mind that the $9,138.15 remained in the corporate accounts, after the reduction of capital stock, as a portion of the former capital and it was, in no sense, like an excess of property, which had been accumulated in the conduct of the business beyond the fixed capital. It did not represent 'surplus profits arising from the business'; it was not within the intendment of the agreement with respect to dividends on the preferred stock

and its distribution, when made, could only be legally effected by dividing it among all the stockholders ratably and without preference."

In *In re Accrington Corporation Steam Tramways Co.*, 1909, 2 Chancery, 40, the question for determination was whether in the distribution of the company's assets, the preference shares, or any of them, were entitled to priority as to capital or income. Upon a sale of assets it appeared there was a deficiency of capital of some £11,250. The profit and loss account showed a balance of £2,687. At the last meeting prior to liquidation a dividend of 6 per cent. was declared on all shares and a balance of £1,186 was carried forward, this being subsequently increased by £480 when the company was wound up and a liquidator appointed. Upon one class of preference stock having a "cumulative preference dividend of 6 per cent. per annum, but without any priority as to capital" there were 13 per cent. dividends in arrears. These shareholders claimed a preference against this £1,186 balance to make up the arrears. The Court held that as no further dividends had been declared out of undistributed profits subsequent to liquidation, the preference holders were not entitled to undistributed profits in respect of dividends and "since the Companies Clauses Acts give them no priority as to capital, the assets must be distributed ratably among all the shareholders of the company in proportion to their capital."

See, also, *Re Ramel Syndicate, Ltd.*, 1911, 1 Ch., 749.

In *In re Frazier & Chalmers, Ltd.*, 1919, 2 Ch., 114, 88 L. J. (Ch.) N. S., 343, it was held that where a resolution creating preference shares defined the rights to all the profits, but with regard to capital on a winding up or dissolution, merely gave preference shareholders a right to be repaid their capital before the ordinary shareholders

ers were repaid and was silent as to any assets which might remain after all the capital was repaid, such assets must be ratably distributed between ordinary and preference shareholders. In commenting on *In re Espuela Land and Cattle Co.*, 1909, 2 Ch., 187, and *Will* v. *United Lankat Plantations, Ltd.*, 1914, App. Cas., 11, the Court said:

> "None of the opinions of the Law Lords [in the Will case] suggest that a preferential right to be repaid capital in a winding up is exhaustive like the dividend provision, and operates to deprive the shareholders having such preference of the right to more than a sum fixed by the face value of their shares, if there is in fact a surplus, after repayment of capital. * * *
>
> "Speaking for myself, I think SWINFEN EADY, J. [in the Espuela case] intended and rightly, to lay down that in the absence of provision to the contrary the shareholders' rights are equal."

See especially p. 348 of the opinion (88 L. J. Ch. N. S.).

In *In re Bridgewater Navigation Co.*, L. R., 39 Ch., Div. 1; 14 App. Cas., 525, there was a fund upon dissolution of a corporation sufficient to pay the debts and the amount invested by the preferred and common stockholders, and to leave a large surplus over. The preferred stock had been fully paid up to the extent of ten pounds per share. The common stock had been paid for only to the extent of three pounds ten shillings per ten pound share. It was held in the Court of the first instance and in the Court of Appeal, that after paying to each preferred stockholders ten pounds per share and to each common stockholder three pounds ten shillings per share, the surplus should be divided among all the stockholders, preferred and common, in proportion to the amount of money actually contributed by each. The common stockholders insisted that the whole of this surplus was profits, and that as they were entitled to all of the profits after paying the 5 per cent. to the pre-

ferred stockholders, they were entitled to the whole of the fund. The Court, however, held that this was untenable, and that the rule contended for by the common stockholders applied only to the annual profits, and not to the large profits arising from the sale of the property of the corporation. In this respect, the decree was affirmed by the House of Lords; but it was there held that the surplus should be divided among the stockholders in proportion to the number of shares held by each, and not in proportion to the amount contributed by each.

VI.

The Plan contemplates not only such a distribution of the capital assets of the Reading Company as will comply with the requirements of this Court and terminate the unlawful combination found by it to exist, but the termination of the corporate life of the Reading Company and the creation of new corporations henceforth separately to control (a) the Coal properties and (b) the Railroad properties.

While the Plan provides that the Reading Company will merge with the Philadelphia & Reading Railway Company

> "under the authority contained in the present charter of the Reading Company, * * *"

the statute governing the merger of the Philadelphia & Reading Railway Company into the Reading Company, is an Act of the Pennsylvania Legislature approved May 3, 1909 (P. L., 408), authorizing one corporation

> "to merge its corporate rights, franchises, powers and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of

this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *"

When the Reading Company is merged with the Railway Company it will lose its identity (*Lauman* v. *The Lebanon Valley Railroad Company*, 30 Pa., 42, 45). In this case the Court said:

"* * * such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved."

The act of 1909 provides the machinery of the merger, including a joint agreement by the Directors of each corporation, its submission to the stockholders of the respective Companies, and the filing of a certificate as to the vote at such meeting in the office of the Secretary of State of the Commonwealth,

"who shall forthwith present the same to the Governor for his approval, and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation."

Upon the filing of such certificate and agreement in the office of the Secretary of State,

"and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement, possessing all the rights, privileges and franchises theretofore vested in each of them, and all the estate and property, real and personal, and rights of action of each of said corporations, shall be deemed and taken to be

> transferred to and vested in the said new corporation without any further act or deed: * * * But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent * * *."

This statute was construed in the case of *Pennsylvania Utilities Co.* v. *Public Service Commission*, 69 Pa. Super. Ct., 612, 618, where it was expressly held that a merger under it had the effect of destroying the corporate identity of all merging companies, the Court saying:

> "It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result."

The result of the Plan, therefore, is the dissolution of the existing Reading Company. On such dissolution all classes are entitled to share equally in the assets, no matter how the latter are distributed. The assets go in two directions: first, the coal assets to the new coal company; second, the railroad equipment, terminals and other assets, to the (new) Reading Company by merger. It is not clear under the Plan, whether or not new certificates of stock of the merged company will be issued in exchange for the certificates of stock of the Reading Company, but

in any event, an equality of distribution between the stockholders is brought about in respect of the assets acquired by the merged company, because the stockholders will have the same *pro rata* stock holdings after the merger as before.

The judges in the District Court pointed out that the holding by the Reading Company of the stock of the Coal & Iron Company was decreed by this Court to be unlawful, and was required to be disposed of so as to establish the independence of the companies from each other; and that such disposition was made by the Plan.

> "From these considerations, it is apparent that whatever this disposition of the stock" (*i. e.*, of the Philadelphia & Reading Coal & Iron Company) "may be called, it is in no sense an earning of the Reading Company which is to be disposed of by that company as a dividend. It is a taking by the law of an asset of that company, a stock asset, which was and has been owned in specie by Reading Company since the Reading reorganization was formed, and which never was earned or could be earned by the Reading Company itself. Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings" per BUFFINGTON, Cir. J. (Rec., pp. 281-282).

The observations made by this Court in *Harriman* v. *Northern Securities Co.*, 197 U. S., 244, with reference to the method adopted by the Northern Securities Company to terminate the unlawful combine of competing lines of railroad, found by this Court to exist, are pertin-

ent to the case at bar. Mr. Chief Justice FULLER in delivering the opinion of the Court said (p. 299):

> "Doubtless it became the duty of the Securities Company to end a situation that had been adjudged unlawful, and this could be effected by sale and distribution in cash, or by distribution in kind, and the latter method was adopted, and wisely adopted, as we think, for the forced sale of several hundred millions of stock would have manifestly involved disastrous results."

VII.

The decisions cited by the Appellants respecting the distribution of net profits of a company arising in the ordinary course of business have no application to the case at bar. The Corporation is not distributing surplus net earnings, it is segregating its capital and business in compliance with the decree of this Court.

It was organized to control the business of coal mining and that of railroad transportation. This Court has held such to be an unlawful purpose. Therefore it is dividing and distributing its properties so as to end that unlawful status, and in the Plan to accomplish such purpose it is mindful of the interests of its stockholders who are equally entitled to share in its capital, without preference or priority.

Appellants Continental Insurance Company, *et al.*, argue that the mandate of this Court

> "does not require the Coal Company's stock to be distributed to Reading Company preferred stockholders. Disposition of the stock of the Coal Company is directed, but the mandate leaves undisturbed the respective rights of classes of stockholders" (p. 36).

This is begging the question. As Judge BUFFINGTON pointed out in the District Court:

> "It will be noted that this stock holding by the Reading Company in the Coal Company was decreed by the Supreme Court an unlawful holding, and was one as to which the Supreme Court directed this Court to enter a decree 'with such provision for the disposition of the shares of stock and bonds and other properties of the various companies, held by the Reading Company as may be necessary to establish the entire independence from that Company and from each other of the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal & Iron Company,' etc." (Rec., p. 280).

The whole gravamen of Appellants' argument is that the distribution of the stocks is a voluntary dividend by the Reading Company. The fact is, that it is a compulsory distribution, made pursuant to the decree of this Court for the purpose of ending an unlawful combination found to exist by reason of the control exercised by the Reading Company over the coal business and the railroad business. The cases cited by Appellants to sustain their argument that, being a dividend, the property must go to the common stockholders, are wholly irrelevant to the present issue, being decisions where accumulated net profits arising from the corporate business were under distribution by way of dividend to the stockholders. See *Stone* v. *U. S. Envelope Co.*, 119 Maine, 394; *Russell* v. *American Gas & Electric Co.*, 152 App. Div. (N. Y.), 136.

In the *Stone* case, the Supreme Court of Maine pointed out the difference in the rule established by the courts in Pennsylvania and the courts in certain other States, and, referring to the latter, adopted a rule avowedly at variance with the Pennsylvania rule. In addition to that, the language of the preferences in each

of those cases was quite different from that in the Reading case. The same observation may be made regarding the recent decision by the United States Supreme Court in *Rockefeller* v. *United States,* and *New York Trust Co.* v. *Edwards,* 42 Sup. Ct., 68. Those cases concerned voluntary distributions of shares of stock of corporations unaffected by provisions similar to those of the Reading stock.

The Appellants, Continental Insurance Company, *et al.,* say:

> "The limitation of the preferred stock to a realization of its par value was from the very beginning regarded, not merely as a limitation on the preferred stock, but as an asset of the common stock" (Brief, p. 44).

Precisely the contrary is the fact. There is no such limitation, as was pointed out in the foregoing points. Not only does the only limitation upon the participation of preferred stockholders in the property of the corporation affect merely the "net profits" of each particular fiscal year, but in the application made in 1904 to list the preferred stock of the Reading Company on the New York Stock Exchange, the following was stated:

> "The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets" (Rec., p. 181).

This was the clear and the correct interpretation put by the officers of the corporation upon the rights of the stockholders before any controversy arose, and upon which all subsequent trading in those stocks must have been conducted. The so-called "practical construction by the interested parties," referred to by Appellants Continental Insurance Company, *et al.* (Brief, p. 45), has reference merely to the fact that dividends on common

stock were for a few years declared and paid in excess of those paid on the preferred stocks. The fact that the corporation reserved the right to redeem the preferred stock for cash at par, has no bearing whatever upon the unrestricted right of the preferred stock to share equally with the common stock in the distribution of assets in liquidation, any more than the right reserved to the stockholders in the charter of the corporation to a *pro rata* share of the capital stock (irrespective of classes) in case it should at any time be increased (Rec., p. 194) determines the right of the preferred stockholders to share *pro rata* with the common stockholders in the distribution of income. The cases cited in the brief of Continental Insurance Company, *et al.* (pp. 46 to 54), upon the construction of the stock certificates, all turn upon different language from that employed in the certificates of the Reading Company. Not only may the Pennsylvania cases

> "be taken as *favoring* the principle that in the absence of any words of limitation in the certificates, when earnings are in excess of the amount of the dividend to the preferred shareholders, the common stockholders thereafter are entitled to a like dividend, and thereafter both preferred and common stockholders are entitled to the excess ratably," (italics ours)

as admitted by Appellants (Continental Ins. Co. Brief, p. 55), but they *establish* that principle, and were it not for the acquiescence of the preferred stockholders in the distribution of dividends to the common stock for several years in excess of those paid the preferred stockholders, these Appellees would feel compelled to urge that as applicable to the present case. It is not the fact, as contended by the Appellants, that the words "preferred stock" have a generally accepted commercial meaning. On the contrary, it has been pointed out in cases too numberless to

require or justify citation that the rights of the holde of preferred stock depend upon the particular contra under which it is issued, and in the face of the speci language of the Reading Company certificates and t unbroken line of decisions construing the rights of pr ferred stockholders in the Supreme Court of Pennsy vania, it is worse than futile to go afield to seek constru tion based upon different language or under rules adopt by the Courts in other States.

The distribution in the present instance, as abo pointed out, is a distribution of capital pursuant to t decree of this Court. The provisions of the Pennsylvan law cited by appellants, Continental Insurance Compan at page 76 of their brief, are applicable to ordinary div dends of net profits made from time to time, and tho dividends are so limited by the statute that they

> "shall in no case exceed the amount of the n proceeds actually acquired by the company,"

to the end that

> "the capital stock shall never be impaired thereby.

These provisions are applicable to the distribution profits by a going concern in the ordinary course of bus ness. They can have no application to the dissolution an unlawful combine and the enforced distribution of it capital assets under circumstances similar to those in th present case. Nor can it be successfully contended, a Appellants endeavor, that the transaction in the stock the Coal & Iron Company is not a sale. As alread pointed out, the stock of the Coal & Iron Company itsel is not sold, but certificates of beneficial interest are sold in the first instance, to the stockholders of the Reading Company, with such restrictions, that before full owner ship can be enjoyed, they must be acquired by someone not interested in the stock of the reconstructed Reading

Company, which is to be a railroad corporation pure and simple.

The utmost possible contention of the appellants is that those rights have a value in excess of the price at which they are offered for sale to the Reading stockholders, and that, therefore, insofar as the difference between the actual market value and the subscription price is concerned, it amounts to a distribution of property of the Reading Company. That property Appellants contend, is a part of the surplus accumulated net profits of the Reading Company, and they seek to apply the rule applicable to the distribution of net profits in the ordinary course of business to that situation. The answer to this proposition appears to us to be two-fold: first, that the transaction is not an ordinary distribution of net profits, but a disposition of capital assets, a segregation of properties to conform with the requirements of this Court; and secondly, that even if a portion of the property distributed is accumulated net profits which have been carried to surplus account, the common stockholders are not entitled to share in the same to the exclusion of the preferred stock, being limited in dividends to the net profits of a particular year, with respect of which full payments shall have been made on the first and second preferred stock.

The observation of Judge BUFFINGTON in his opinion in the District Court, is apposite:

> "* * * it will be noted that the mandate directs a 'disposition of shares of stock and bonds and other property held by the Reading Company,' and in that respect the mandate has been complied with precisely, in that there has been a '*disposition*' of the stock, it being taken from the Reading Company, and it has not even been distributed by that Company, but, treating it as an unlawful holding of that Company, it is to be taken by the Court and disposed of absolutely by it, by sale through the

> agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it" (Rec., p. 281). (Italics ours.)

It is submitted that the method adopted by the District Court to meet the requirements of the decision in this Court is proper, and that no such inequitable division as is contended for by the common stockholders' plans can be approved by this Court.

The language of the opinion of the District Court so well sums up the position of these appellees, that we are content to rest our case on its reasoning.

Circuit Judge BUFFINGTON said:

> "Seeing then that this stock is not an earning of the Reading Company to be distributed as a dividend, but is a part of its capital disposed of in this case to qualifying shareholders, in the manner provided for by the creation of this intermediate corporation, it will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets. We are therefore of opinion that the plan which embodies these equitable principles should be approved and that the claim of the common shareholders to take all of this stock to the exclusion of the preferred stockholders should be denied. And in approving such plan we note that in point of fact the equity of a common participation of all stockholders, preferred and common, has not only the approval of the Government of the United States that has no interest in the controversy, save to see that equity is done to all; of the Reading Company which has no interest save an impartial stewardship for all its shareholders; and lastly the silently expressed approval of sub-

stantially two-thirds of the shares held by common stockholders. This significant and impressive fact cannot but be regarded as highly persuasive of the substantial equity of this Plan" (Rec., p. 282).

It is therefore respectfully submitted that the decree should be affirmed.

CADWALADER, WICKERSHAM & TAFT,
Solicitors for Adrian Iselin and others as a Committee representing Certain First and Second Preferred Stockholders, Appellees.

GEORGE W. WICKERSHAM,
EDWIN P. GROSVENOR,
of Counsel.

Nos. 609 & 610.

OCTOBER TERM, 1921.

IN THE

Supreme Court of the United States

CONTINENTAL INSURANCE COMPANY
AND
FIDELITY-PHENIX FIRE INSURANCE COMPANY
OF NEW YORK, Appellants,

vs.

READING COMPANY, ET AL., Appellees.

SEWARD PROSSER, ET AL., Appellants,

vs.

READING COMPANY, ET AL., Appellees.

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR JOSEPH E. WIDENER, APPELLEE.

ELLIS AMES BALLARD,
Attorney for Appellee.

BALLARD, SPAHR, ANDREWS & MADEIRA,
Of Counsel.

ALLEN, LANE & SCOTT, PRS., PHILADELPHIA.

In the Supreme Court of the United States.

OCTOBER TERM, 1921. NOS. 609 AND 610.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, Appellants,

vs.

Reading Company, et al., *Appellees.*

Seward Prosser, et al., *a Committee, &c., Appellants,*

vs.

Reading Company, et al., *Appellees.*

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

ARGUMENT FOR JOSEPH E. WIDENER, APPELLEE.

A COMMON STOCKHOLDER.

This appellee has the largest individual interest in this controversy. He is trustee of the estate of his father—the late P. A. B. Widener—which owns 100,000 shares of

Reading common stock, a one-fourteenth part of the whole issue. Appellee is a beneficiary to the extent of 50 per cent. in the estate and also has a considerable holding of common stock in his own name. Neither appellee nor the Widener estate owns any preferred stock. Appellee is also a director of the Reading Company.

Appellee gives this plan his hearty and unqualified approval.

The problem under the mandate of this Court was to devise a plan which would

1. Effectually dissolve the illegal combination.

2. If possible impinge on no legal rights of the parties interested.

3. Do substantial justice to all interests.

This plan meets these three requirements.

I. It accomplishes the dissolution of the illegal combination.

No exception has been taken to the plan as not fully meeting the mandate of this Court. It effectually dissolves the illegal combination of coal mining and transportation business, and it destroys the agency (the special charter of the Reading Company) which made the illegal combination possible.

II. It impinges on no legal rights.

It was devised with this object in view and it accomplishes that object.

(*a*) There is a most elaborate and seemingly complicated interstockholder contract in The Reading Company, but it deals with but one problem—the distribution of current earnings. With respect to these the preferred stock is preferred and limited to four per cent. All of the rest that the directors distribute must go to the common stock, and for the past ten years with the different classes of stockholders

ably represented on the Board there has been no difficulty or difference of opinion as to how to apply this arrangement. The preferred stocks in each year have received four per cent. and no more, and all the rest of the earnings distributed as dividends—six per cent., seven per cent. and eight per cent.—has been paid to the common stockholders.

(*b*) There is to be found in this interstockholder contract no affirmative word as to distribution of accumulated surplus. There is a proviso from which inference may be drawn that it may be distributed (except in certain cases) to the common stockholders alone,—or the clause may be given a meaning consistent with the theory of the preferred stockholder—that earnings not currently distributed become a permanent fund for the greater safety of the limited preferred dividend:—that such accumulated profits become captial assets—whatever that may be—and can never become the property of the stockholders except in liquidation. These two views are most ably presented in the brief filed on behalf of the common stockholders, appellants, and the preferred stockholders.

This appellee presents no argument on this point. One of the great merits of this plan is that it does not raise this question but leaves the rights of the parties exactly where it finds them.

(*c*) The contract is silent as to distribution in liquidation. Therefore under the law, particularly the Pennsylvania law, all shareholders share equally. This proposition is admitted by all parties and need not be elaborated.

Now the whole argument of the appellants consists, first, in setting up that the distribution of valuable rights—*compelled by decree of the court and not through the untrammelled exercise of discretion by directors—is a dividend*—in the cutomary meaning of the word.

Even if appellants establish this position they do not sustain their appeals, for the interstockholder contract deals only with dividends from current earnings and possibly from accumulated surplus. And this coal property illegally acquired in 1896 is certainly neither.

Either this transaction is a resale to the original vendors (the preferred and common stockholders as an unsegregated group) of this coal property—or it is a partial liquidation of capital assets upon dissolution of The Reading Company. For the Reading Company is dissolved under the plan. It is merged with the Railway Company. That merger so far as the railway company is concerned must be under the Pennsylvania Act of 1909, which definitely provides for the erection of a new company in place of the old.

While the dissolution is complete the *liquidation* is only *partial*, and the present arangement between stockholders is continued as to profits arising from operation of the railroad.

This brings us to the third point of this argument.

III. THE ARRANGEMENT IS FAIR.

(*a*) Let us look at the results accomplished. It is true the preferred stockholder is getting something of substantial value. But had he insisted on his extreme rights, had he refused to permit his capital to continue in the curtailed enterprise at a return entirely inadequate in the present money market, he could have forced complete liquidation as well as complete dissolution, and have shared equally with the common stock in distribution. The danger to the common stockholder in the present emergency is that, should he be successful in his appeal, this is exactly what will happen, for the merger can only take place if it commands a majority vote of the stock and it cannot command that majority unless the preferred stock shares in the rights.

(*b*) This appellee most sincerely believes that even if the preferred stockholder gets under the plan something that he is not legally entitled to, he is giving up more than he is getting.

If the common stock is giving up something, it is getting in return the use of $70,000,000 of preferred stockholders' money at a limited return of four per cent., non-cumulative. All further earnings from the use of this money in the railroad business accrue to the common stockholder.

How foolish for the common stockholder to jeopardize this arrangement by insistance upon doubtful legal rights, the establishment of which would drive the company to complete liquidation.

(*c*) As an alternative, the coal property might be offered to outside and independent parties, but no proposal has come from such, and the present plan accomplishes the same result by a sale at retail through stockholders and at a profit which the stockholders might not otherwise secure.

(*d*) As another possible alternative, the company might elect to eliminate the preferred stock, but this requires the raising of either $49,000,000 or $70,000,000 in this money market with which to retire a four per cent. obligation—a very expensive proceeding.

(*e*) The appellants have chosen this forum in which to be heard, although the question is in no sense a federal one. They will therefore be bound by the decision of this court and cannot again raise the same questions in the state courts —and so further delay the winding up of this illegal combination. But if any stockholder not having assented to this plan feels aggrieved at the terms of the merger under which the railroad enterprise alone is hereafter to be carried on, the law of Pennsylvania permits him to withdraw his interest in cash as that interest may be determined by a jury.

In Conclusion.

The plan submitted overcomes the serious difficulties of attempting to sell so large a property to a single purchaser or syndicate in the present market. It avoids the necessity of refinancing an issue of $49,000,000 or $70,000,000 of four per cent. money. It dissolves the agency which made the illegal combination possible while preserving the goodwill and organization of the Railroad property and the inter-stockholder relationship with respect to division of profits. The plan has received the approval of the Department of Justice and of the District Court; the approval of the bondholders and preferred stockholders; the approval

of the Reading Company acting through its duly constituted board of directors. The only dissent comes from a minority —and a minority only—of the common stock, and it is perfectly apparent that if this interest succeeds in its present appeal, it will be to its own loss and discomfiture.

ELLIS AMES BALLARD,
For Joseph E. Widener, Appellee.

BALLARD, SPAHR, ANDREWS & MADEIRA,
Of Counsel.

IN THE

SUPREME COURT of the UNITED STATES.

OCTOBER TERM, 1921.

No. 609.

CONTINENTAL INSURANCE COMPANY and FIDELITY-PHENIX FIRE INSURANCE COMPANY OF NEW YORK,

Appellants,

—against—

READING COMPANY and Others,

Appellees.

No. 610.

SEWARD PROSSER, MORTIMER N. BUCKNER and JOHN H. MASON, as a Committee, etc.,

Appellants,

—against—

READING COMPANY and Others,

Appellees.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR READING COMPANY.

CHARLES HEEBNER,
R. C. LEFFINGWELL,
WM. CLARKE MASON,
L. D. ADKINS,
A. I. HENDERSON,
Of Counsel

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Appellees.

APPEALS FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

BRIEF FOR READING COMPANY.

The statements of the case and of the facts in the briefs for appellants contain much which invites controversy. Believing, however, that such

controversy would be irrelevant to the legal question presented by these appeals, the following summary statement is made, in lieu of a detailed analysis of the statements contained in the briefs for the appellants, in the effort to present briefly the facts deemed necessary to an understanding of the issue.

SUMMARY STATEMENT.

The Government's Dissolution Suit

This cause originated as a proceeding brought by the Government of the United States to dissolve the intercorporate relations existing between the corporate defendants on the ground that such relations constituted a violation of the Sherman Anti-Trust Act (26 Stat. 209), and also of the commodities clause of the Act of Congress of June 29, 1906 (34 Stat. 584, 585) (Record, p. 2).

The Decision of This Court

On April 26, 1920, this Court handed down an opinion in which this Court among other things directed the District Court to enter a decree (Record, p. 25)

> "dissolving the combination of the Reading Company, the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire

independence from that company and from each other, of the Philadelphia and Reading Railway Company, the Philadelphia and Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh and Wilkes-Barre Coal Company, and also that such disposition shall be made by the decree of the stocks and bonds of the Lehigh and Wilkes-Barre Coal Company, held by the Central Railroad Company of New Jersey, as may be necessary to establish entire independence between these two companies to the end that the affairs of all of these now combined companies may be conducted in harmony with the law." *United States* v. *Reading Company*, 253 U. S. 26 (Record, pp. 1-26).

The Interlocutory Decree of the District Court

The Mandate of this Court was filed in the District Court on August 13, 1920 (Record, p. 27), and thereafter on October 8, 1920, the District Court entered a Decree on Mandate (Record, p. 31), which among other things ordered that

> "the defendants shall submit to this Court a plan for the dissolution of the unlawful combination between the Reading Company, the Philadelphia & Reading Railway Company, the Philadelphia & Reading Coal and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, existing and maintained through the Reading Company, with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence from that company and from each other, of the Philadelphia & Reading Railway Company, the Philadelphia and Reading Coal

> and Iron Company, the Central Railroad Company of New Jersey and the Lehigh & Wilkes-Barre Coal Company, to the end that the affairs of all these now combined companies may be conducted in harmony with the law."

Accordingly on February 14, 1921, a plan was filed by the Reading Company, the Philadelphia and Reading Railway Company (hereinafter called the Railway Company) and The Philadelphia and Reading Coal and Iron Company (hereinafter called the Coal Company) (Record, p. 40). That Plan was approved by the then Attorney General of the United States, except as to the disposition to be made of the stock of The Central Railroad Company of New Jersey (Record, p. 45).

The board of directors had approached the formulation of the Plan from the point of view, first, of obeying the Mandate of this Court; second, of avoiding as far as possible the disturbance of existing securities; and third, of doing justice between existing classes of security holders (Record, p. 154).

Promptly after filing the Plan the Reading Company sent a copy to each of its stockholders with a letter dated February 14, 1921, summarizing it (Record, pp. 156, 186). Stockholders and holders of bonds issued under the General Mortgage of the Reading Company and the Coal Company, were permitted to intervene, and the Trustee under said General Mortgage was made a party defendant (Record, p. 203). The Reading Company and its board welcomed the intervention of all stockholders as tending to relieve them of the sole responsibility in a matter which was evidently controversial (Record, p. 154).

The stockholders who filed petitions to intervene are as follows:

	Number of Shares	
For the Plan	Preferred	Common
New York Central Railroad Company (Record, p. 140)	406,600	197,050
The Baltimore and Ohio Railroad Company (Record, p. 142)	406,600	200,050
Madge Fulton Kurtz (Record, p. 208)	1,000	
William B. Kurtz (Record, p. 208)	8,650	
Iselin Committee (Record, p. 209)	226,333	
Joseph E. Widener (Record, p. 209)		101,900
Total	1,049,183	499,000
Against the Plan		
Prosser Committee (Record, p. 208)		407,728
The Insurance Companies (Record, p. 208)		8,400
Total		416,128

A petition to intervene was filed by Girard Avenue Title and Trust Company stating that it owned 900 shares of common stock. It has not, however, joined in the appeal and the petition does not give an indication of its attitude toward the Plan (Record, p. 145).

A petition for information was filed by Frances T. Ingraham owning common stock (Record, p. 120).

The capital stock of the Reading Company

amounts to $140,000,000, divided into 2,800,000 shares of the par value of $50 each, of which $70,000,000 is common stock and $70,000,000 is 4% non-cumulative preferred stock. Of the latter $28,000,000 is first preferred and $42,000,000 second preferred (Record, p. 157).

Seward Prosser, Mortimer N. Buckner and John H. Mason as a Committee, etc., appellants, are in the above table and hereinafter referred to as the Prosser Committee.

Adrian Iselin, Robert B. Dodson, Edwin G. Merrill and William A. Law as a Committee, etc., appellees, are in the above table referred to as the Iselin Committee.

Continental Insurance Company and Fidelity-Phenix Fire Insurance Company of New York, appellants, are in the above table and hereinafter referred to as the Insurance Companies.

By order filed April 12, 1921 (Record, pp. 205-207), the District Court set down for argument on May 2, 1921, a number of questions, two of which, raised by the Trustee under the General Mortgage and the bondholders, were eliminated by modifications of the Plan (Record, p. 210) and one of which is the question involved in these appeals. *i. e.,* whether paragraph five of the Modified Plan (Record, p. 275), "confers upon any one class of stockholders of the Reading Company any benefit to the prejudice of the legal rights of any other class of stockholders." After the argument a Modified Plan was filed on May 12, 1921 (Record, p. 274).

Summary of Modified Plan

The Modified Plan may be summarized as follows:

(a) *The Philadelphia and Reading Coal and Iron Company.* The Reading Company will as-

sume the $96,524,000 General Mortgage 4% Bonds which are the joint obligation of the Reading Company and the Coal Company, will receive from the Coal Company $10,000,000 in cash or cash assets and $25,000,000 in 4% Mortgage Bonds of the Coal Company, and will exchange general releases with the Coal Company (Record, p. 274). The Reading Company owns all the stock (par value $8,000,000) of the Coal Company, subject to the lien of the General Mortgage (Record, p. 157). The Reading Company will, subject to the lien of the General Mortgage, sell its interest in the stock of the Coal Company for $5,600,000 to a new corporation created by the Court's order (Record, p. 275), of which the Court will retain control so as to prevent its being used to thwart the decree (Record, p. 284; *United States* v. *E. I. Du Pont de Nemours & Company*, 273 Fed. Rep. 869). Assignable certificates of interest in the stock of the new corporation, exchangeable for such stock only when accompanied by an affidavit that the holder is not the owner of any stock of the Reading Company, will be offered for sale to the stockholders of the Reading Company, preferred and common, share and share alike for $5,600,000 or $2 for each share of Reading stock (Record, p. 275).

(b) *The Philadelphia and Reading Railway Company.* The Reading Company owns all the stock (par value $42,481,700) of the Railway Company, subject to the lien of the General Mortgage (Record, p. 157). The Reading Company will merge the Railway Company and will subject the railway property to the direct lien of the General Mortgage, will accept the Pennsylvania Constitution of 1874 and proceed under the Pennsylvania Act of 1856 to surrender

those of its powers which are inappropriate for a railroad corporation of Pennsylvania. Thus the Reading Company will be in all respects subject to the regulation of State and Federal authorities as a common carrier and the relation of the Reading Company as a specially chartered holding company to the Railway Company will be terminated (Record, pp. 276-277).

(c) *The Central Railroad Company of New Jersey.* The Reading Company owned stock of The Central Railroad Company of New Jersey to the par amount of $14,504,000, constituting more than a majority of its stock, subject to the pledge thereof under the Jersey Central Collateral Trust Mortgage securing bonds to the amount of $23,000,000 (Record, p. 158). The Reading Company was directed to transfer to Trustees appointed by the District Court, subject to the lien of the Jersey Central Collateral Trust Mortgage, its right, title and interest in the stock of The Central Railroad Company of New Jersey; the final disposition of said stock to be deferred, in view of the possible groupings of railroads by the Interstate Commerce Commission under the Transportation Act of 1920, (41 Stat. 456, 480,) until ordered by said Court (Record, pp. 277, 296-297).

(d) *The Lehigh and Wilkes-Barre Coal Company.* The Central Railroad Company of New Jersey was directed to dispose of all the capital stock of The Lehigh and Wilkes-Barre Coal Company owned by it to persons or corporations who are not its own stockholders, or stockholders of either the Reading Company, the Railway Company or the Coal Company and who, previous to or at the time of the purchase shall qualify as purchasers by a duly executed affidavit in one of the forms annexed to the decree (Record, p. 298).

The Modified Plan was approved by the present Attorney General of the United States, except as to the disposition to be made of the stock of The Central Railroad Company of New Jersey (Record, p. 277).

On May 21, 1921, the District Court (Buffington, Davis and Thompson, JJ., sitting under the Expediting Act so-called) rendered an opinion unanimously approving the Modified Plan (Record, p. 278), and on June 6, 1921, entered a Final Decree in accordance with that opinion (Record, p. 287). The Modified Plan is hereinafter called the Plan.

Facts Bearing Upon These Appeals

The book value of the coal property on the books of the Reading Company, taking the par amount of the stock, plus the nominal amount of the claim of the Reading Company against the Coal Company as carried on the books of those companies as of December 31, 1920 (Record, p. 162), was..... $77,357,017.99

From the Coal Company, the Reading Company will receive $35,000,000 as follows (Record, p. 163):

Cash and cash assets from Coal Company	$10,000,000
4% Mortgage Bonds of Coal Company at par	25,000,000
Total	$35,000,000

The book loss to the Reading Company on the settlement with the Coal Company will be $42,357,017.99

For its right, title and interest in the stock of the Coal Company after the settlement has been made the Reading Company will receive from the new corporation (Record, p. 275) $5,600,000.00

The net book loss to the Reading Company upon the completed transaction therefore will be.... $36,757,017.99

The new corporation will sell to the stockholders of the Reading Company, for $5,600,000, assignable certificates of interest in the stock of the new corporation, which certificates may be exchanged for such stock only when accompanied by an affidavit that the owner does not own any shares of stock in the Reading Company (Record, pp. 275, 276). Probably the actual value of the certificates of interest in the stock of the new corporation lies somewhere between $42,357,017.99, the book value to the Reading Company of the interest in the Coal Company sold by it to the new corporation and $5,600,000, the purchase price to be paid by subscribers to the new corporation for certificates of interest. That the right to subscribe for the certificates of interest is a valuable right is not denied; just how valuable it is, is undetermined.

In the brief for the Insurance Companies the statement is made (p. 27) that the Plan contemplates "a dividend of from $13.50, minimum market value, to $22 actual value per share" of Reading stock—the smaller valuation being based upon market quotations for Reading "rights" so called, and the larger upon the book value of the coal property on the books of the Coal Company. The book value on the books of the Coal Company is larger than that on

the books of the Reading Company by the amount of the accumulated book surplus of the Coal Company; but it is not believed that the certificates of interest can be sold under pressure of the decree in this cause for a sum as great even as the book value of the coal property on the books of the Reading Company would indicate (Record, p. 163). Reading "rights," so called, are dealt in on the Curb "when as and if issued." As the "rights" have no existence pending the decision of this Court the quotations for them represent transactions in which some sell non-existent "rights" without delivering them, and others buy the "rights" without paying for them. Such quotations do not furnish a very reliable indication of what the stockholders of the Reading Company may expect to realize for the "rights," or for the certificates of interest, when transactions cease to be hypothetical and the market reflects forced selling by all holders who are unwilling to part with their Reading stock.

The question of actual value is not, however, of importance on these appeals, for concededly the right to subscribe for the certificates of interest is a valuable right and the legal principles governing the disposition of that right must be the same whether its actual value be greater or less.

THE PRESENT ISSUE.

The appellants contend that the right to subscribe for the certificates of interest described in paragraph (a) of the above summary (paragraph five of the Plan—Record, p. 275) belongs to the common stockholders of the Reading Company, and to them alone, to the exclusion of preferred stockholders (Record, pp. 317-320, 333-337). The Reading Company believes that the right to subscribe was properly accorded to all stockholders, share and share alike. This is the only issue presented by these appeals.

ARGUMENT.

I.

The preferred stock of the Reading Company, though preferred and limited as to current dividends to 4%, is neither preferred nor limited as to assets.

Preferred stocks for the purposes of the present discussion may be roughly classified as follows:

(1) *Non-Participating Preferred Stocks.*

Non-participating preferred stocks are by their terms preferred both as to dividends and assets. The holders are entitled to receive a specified dividend if earned, and in case of liquidation or dissolution are entitled to receive the par amount of their shares out of the assets of the company before any payment is made to the holders of the common stock, but if the assets exceed the par value of the preferred and common stocks together they are not entitled to share in such surplus assets, which go to the holders of the common stock exclusively. The preferred dividend may or may not be cumulative. Since the holders of preferred stock of this character have an interest in the capital assets of the company only to the extent of the par value of their shares, they should not be entitled to share with the holders of common stock in a stock dividend nor to subscribe ratably with the holders of common stock for any new issue of stock since their interest is not affected by an increase in the com-

mon stock. There is complete mutuality. The common stockholders consent that in the event of liquidation or dissolution of the enterprise the preferred stockholders shall be entitled to receive the full par value of their stock, though the assets be insufficient to pay one cent to the common, and, on the other hand, the preferred stockholders agree that if the assets are more than sufficient to pay them and the common stockholders the par value of their stock, then the surplus assets shall go to the common stockholders exclusively. Although it is dangerous to generalize, it seems to be the more modern fashion to issue preferred stocks of this character. The preferred stocks discussed in the following cases cited in the briefs of the appellants are of this character: *Stone* v. *United States Envelope Company,* 119 Me. 394; *Russell* v. *American Gas and Electric Company,* 152 App. Div. (N. Y.) 136; *Niles* v. *Ludlow Valve Mfg. Company,* 196 Fed. Rep. 994, 202 Fed. Rep. 141; *Will* v. *United Lankat Plantations Company,* 106 L. T. Rep. (N. S.) 531, [1912], 2 Ch. 571, [1914] A. C. 11.

(2) *Participating Preferred Stocks.*

(a) *Participating as to Dividends.* Preferred stocks of this character are preferred but not limited as to dividends. The holders are entitled to receive a stipulated dividend before any payment is made on the common stock, and after the common stock has received a like dividend, are entitled to participate ratably in any distribution of the remaining surplus earnings.

(b) *Participating as to Assets.* Preferred stocks of this character are generally not preferred and never limited as to assets. In case of the liquidation or dissolution of the cor-

poration, the holders of such preferred stocks share ratably with the holders of the common stock in the assets. If there are sufficient assets to pay the par value of both the common and preferred in full, any surplus is shared ratably by the preferred and common stockholders; if there are insufficient assets to pay the par value of both the preferred and common in full, any deficit is borne ratably by the preferred and common stockholders.

(c) *Fully Participating Preferred Stocks.* These stocks combine the characteristics of (a) and (b).

Participating preferred stocks are discussed in the cases cited in points II and VIII of this Argument.

No attempt is made here to describe every possible permutation and combination of the above principal factors. It is safe to say that the foregoing are the general categories into which preferred stocks may properly be classified for purposes of this discussion.

Preferred stock which is non-cumulative as to dividends ought, as a matter of sound financial structure, to be participating as to assets in order that, if the holders of such stock are forced to contribute to the strength of the corporate enterprise by foregoing their dividends, they may participate fully in the resulting enhancement of the assets in case it becomes necessary to dispose of them otherwise than by way of current dividends.

Similarly, if the preferred stock is entitled to participation as to assets, it is highly desirable that the privilege of redemption be reserved by the company in order that it may be possible to retire it if in the interests of the company it

should prove advantageous to do so—a privilege which would doubtless be of little or no value in the case of a stock bearing non-cumulative dividends at a rate as low as 4% which did not have the participating feature.

The Reading Company's preferred stock falls into (2 b) of these categories: it is a non-cumulative, semi-participating, redeemable preferred stock, preferred and limited as to current dividends, but otherwise fully participating (Record, pp. 88-93, 181).

A quarter of a century ago, when the present issues of stock were made, the Reading Company had been through a drastic reorganization, and had a record of misfortune (Record, pp. 216-227, 259). To give the common stock any value at all at the time and ensure the consummation of the reorganization, it was doubtless necessary not only to limit the current dividend on the preferred stock to 4%, but to make that dividend non-cumulative, and to deny the preferred stock any preference as to assets. The possibility of a financial disaster must have been very much present to the minds of the security-holders of the Reading Company when it made its first bow after the reorganization of 1896. To confer a preference as to assets on the preferred stock would have been to give it an advantage over the common, in the then not improbable event of a further reorganization, altogether incommensurate with the value which, as a non-dividend paying non-cumulative 4% stock, it had during the early years of the reorganized company. True, it followed as a matter of course from the absence of any preference as to assets, that no limitation was imposed as to partici-pa-

tion in assets; but that no doubt did not seem a very important matter to holders of the common stock at the time of the reorganization. The Reading Company did not pay any dividend on the preferred stock until 1900, nor the full dividend on the preferred until 1903, and did not pay any dividend on the common stock until 1905 (Record, p. 58).

The fact that Reading preferred was neither preferred nor limited as to assets was well understood, and the application, made to the New York Stock Exchange for listing the stock of the Reading Company upon the dissolution of the voting trust, (Listing Statements, New York Stock Exchange, Vol. 7, A2986 Oct. 15, 1904) contains the following statement (Record, p. 180):

> "The Preferred and Common Stocks have equal voting power and in liquidation or dissolution of the corporation will share equally in *pro rata* distribution of assets."

The fact that the preferred was entitled to full participation in any distribution of the assets otherwise than by way of dividend was recognized by the market. After the decision of this Court directing the dissolution of the Reading combination the preferred stock of the Reading Company sold as high as $61 per $50 share of first preferred stock and $65 per $50 share of second preferred stock, that is at premiums of 22% and 30% of par respectively. The preferred stocks fell off later, however, and, after the announcement of the Plan, sold at $45 for the first preferred and $46 for the second preferred, or a discount of eight or ten per cent. of the par value thereof. (Record, pp. 123, 124, 128). Reading preferred stocks sell higher than other preferred stocks for years

recognized as their equal in soundness and security, for example, Norfolk & Western Railway preferred, and Union Pacific Railroad preferred, both 4% non-cumulative stocks (Record, pp. 123, 124).

Notwithstanding the facts above stated concerning preferred stocks in general (which are a matter of common knowledge) the view is advanced in the brief for the Insurance Companies that all preferred stocks are, or ought to be, alike (pp. 56, 59):

> "Stock certificates, preferred and common, are sold in vast volume throughout the United States.
>
> "The term 'preferred stock' has acquired a well-defined meaning. The Court in the *Stone* case based its decision largely on 'the common meaning of the language.' It would be most unfortunate for preferred stock to mean one thing in one jurisdiction and another thing in another."
>
> * * * * * *
>
> "A certificate of preferred stock is a commercial document; likewise a certificate of common stock. The words have a generally accepted commercial meaning. As said by the Court in *Stone* v. *U. S. Envelope Company, supra.*
>
> > "'Surely the phrase 'preferred stock' holds out to the ear of the ordinary investor no promise of participation in earnings beyond his preferential dividend';
>
> and, quoting from *Will* v. *United Lankat Plantations Company, supra,*
>
> > "'Preferential shares of stock are ordinarily spoken of and regarded, and I think properly regarded, as shares of stock which carry a fixed preferential dividend and are not entitled to anything more.'"

This view does not represent the law in Pennsylvania or anywhere else where the right of

contract exists and is protected. It is not the function of the Courts to write contracts for the parties. The dictum quoted from *Will* v. *United Lankat Plantations Company,* occurs in the opinion of Cozens-Hardy, M. R., in the Court of Appeal. The decision was affirmed in the House of Lords, but there Viscount Haldane, L. C., correctly said, [1914] A. C. 11, p. 15:

> "My Lords, this appeal raises a question of great interest from a business point of view, but it is difficult to see how it can be said to raise any question of general legal principle. The point in dispute is one of construction, *and construction must always depend on the terms of the particular instrument;* it is only to a limited extent that other cases decided upon different documents afford any guidance. I make that observation because a good deal of authority has been cited in the course of the argument, and reference has been made to dicta of various learned judges. But in all those cases they were dealing with documents which were different from those we have to construe, and our primary guide must be the language of the documents we have before us." (Italics ours.)

There is not one word in the stock certificates of the Reading Company to express or even to suggest the view that its preferred stock is entitled to a preference or is subject to a limitation with respect to the disposition of assets otherwise than by way of customary dividends from current earnings.

This distinction between the rights of the stockholders *inter sese* in the case of customary distributions from current earnings, and the rights of the stockholders upon such a disposition as is made of the stock of the Coal Company pursuant to the Plan, is precisely the distinction which was

taken by the District Court in its opinion when, after an analysis of the Plan and reaching the conclusion that "the letter and spirit of the mandate of the Supreme Court are complied with" (Record, p. 280), it said of the stock of the Coal Company (Record, p. 281-282):

> "* * * It is to be taken by the Court and disposed of absolutely by it, by sale through the agency of a corporation created under the provisions of this decree, to such persons as have qualified to lawfully acquire it. * * * Indeed it is now disposed of in substantially the same way as the law would dispose of the property of that company were it being dissolved, and in that connection we deem it proper to say that, under the facts and circumstances before us, the legal question of dividend distribution between different classes of stockholders is not here involved, and on that question we express no present opinion for the simple reason that we are not dividing profits or earnings. * * * It will be apparent that this decree of equal right to all shareholders, preferred and common alike, to participate in the sale as ultimate purchasers, is based on the general equitable principle that equality is equity and on the corporate right of all shareholders in a Pennsylvania corporation to share equally on a disposition of its assets."

The stock certificates are set out in full in the Record, pp. 82-93. There is no material difference between the certificates originally issued at the time of the reorganization in 1896, set out on pages 82-87 of the Record, and the certificates now in use, set out on pages 88-93, nor, for the purposes of these appeals, between the first and second preferred stocks.

It is clear that the Reading preferred stock is preferred and limited as to current dividends

It is equally clear that it is neither preferred nor limited as to assets in case of liquidation or dissolution. The problem is presented whether the disposition made of the interest in the Coal Company and of the certificates of interest in the stock of the new coal corporation is to be regarded as governed by the rule applicable to customary dividends from current profits or, on the contrary, by the rule governing the disposition of assets on liquidation or dissolution. The Reading Company believes that a consideration of the decision of this Court, of the interlocutory decree of the District Court entered upon the Mandate of this Court, of the corporate history of the Reading Company, the Coal Company and the Railway Company and of the action taken and to be taken by the Reading Company and the companies which it controlled at the time of the decree, shows conclusively that there are present in this situation few, if any, elements characteristic of customary dividends, and no current profits to be disposed of; that the accumulated surplus of the Reading Company does not in any sense belong to the common stock, although a question undetermined exists as to the right of the Reading Company to draw upon such surplus for customary dividends; and that, on the other hand, the decree directs and the Plan effects the disposition of all the assets of the Reading Company, the termination of its corporate life, of its business life as a holding company and its regeneration as an operating railroad company, subject to the control of the State and Federal authorities as a common carrier. Surely it is the narrowest sort of a technicality and precisely subversive of the common sense and practical justice of the

situation to assert that such benefits, if any, as may accrue to the stockholders of the Reading Company are to be disposed of under all these circumstances pursuant to the rule governing customary dividends, rather than the rule governing the disposition of assets on liquidation or dissolution.

The Argument will proceed to an analysis of the decided cases, of the facts in the Reading case, and of the contract embodied in the Reading stock certificates, with a view to showing that the rule in the stock certificates governing current dividends is inapplicable to the disposition made of the coal stock and the certificates of interest in the new coal corporation under the Plan; and finally to an analysis of the law and the facts with a view to showing that the rule governing the disposition of assets does apply.

II.

Under the law of Pennsylvania preferred and common stockholders have equal rights except as expressly limited by the terms of the contract between them. No preference or limitation can be implied.

Since the Reading Company is a Pennsylvania corporation (Record, p. 189) the contract between it and its stockholders and between the stockholders *inter sese* should be construed in accordance with the law of Pennsylvania. The Pennsylvania cases establish beyond dispute the principle that, except as otherwise expressly provided in the charter or stock

certificates, preferred and common stockholders have in all respects equal rights and privileges, and that no limitation on these rights is to be implied because of any preference granted. *Englander* v. *Osborne*, 261 Pa. St. 366; *Sterling* v. *H. F. Watson Company*, 241 Pa. St. 105; *Sternbergh* v. *Brock*, 225 Pa. St. 279; *Fidelity Trust Company* v. *Lehigh Valley Railroad Company*, 215 Pa. St. 610.

In *Fidelity Trust Company* v. *Lehigh Valley Railroad Company*, 215 Pa. St. 610, the Railroad Company had issued preferred stock subject to the following charter provisions:

> "And the said additional stock so issued shall be entitled to a preference over all the other stock of the said company, in every future dividend of profits which may be declared by the said company, until the holders of such additional stock shall have been paid, from the funds applicable to the payment of such dividend, ten per cent. per annum on the amount of the capital stock of the company represented by said shares of additional stock so held by them respectively; and the holders of the other stock of the company shall not be entitled to participate in any future dividend of the profits of the company until the holders of said additional stock shall have been paid from the funds applicable to such dividend, ten per cent. per annum on the amount of the capital stock of the company represented by said additional shares so held by them respectively."

Dividends were declared for many years in varying amounts, but all dividends in excess of 10% had always been declared equally to common and preferred. From 1893 to 1904 no dividends were declared, and in 1904 a dividend of 10% on the preferred and 1% on the common

was declared. A preferred stockholder filed a bill to enjoin the payment of any dividends to the common until the preferred had been paid cumulative dividends of 10%. The injunction was granted, the Court holding that the dividends were cumulative, and that the dividends in excess of 10% paid to the preferred stockholders had been properly paid and could not be charged against the arrears of dividends due. In discussing the last point the Court said at page 617:

> "The preference created by the statute gave to the holders of the preferred stock, the right to receive $5 per share per annum on each share of stock held by them, before the other stockholders were entitled to anything. That was the extent of the preference. If the funds applicable to a dividend amounted to just enough for that purpose the other stockholders took nothing. But when each class of stock had been paid 10 per cent., they were equal, and equally entitled to partake of whatever remained in the fund applicable for dividend purposes. The preferred stockholders were not creditors, nor was the amount paid to them in excess of 10 per cent. in any one year to be charged to them as an advance payment upon any future dividends that might be earned or divided in coming years. There was no preference shown in the distribution of these extra dividends. All the shareholders fared alike in so far as they were concerned. The preference created under the act of assembly went only so far as to give to the preferred stockholders a right to claim the first proceeds out of the fund applicable to dividends, to the extent of $5 per share, per annum on their stock, and no farther. After that amount was paid the common

stockholders were entitled to participate, and did so participate, taking during the years when the extra dividends were paid, the same amount per share, as the preferred stockholders. So that the extra payments during the years mentioned cannot be considered as overpayments to the holders of preferred stock. If the preferred stockholders had been limited, under the terms of the contract, to 10 per cent. per annum in any one year, and all the balance of the fund had belonged exclusively to the common stockholders, then the contention that these extra dividends should be set off as against the arrears would be sound. But there is no such limitation in the act. The preferred stockholders stood upon the same plane as the others, with the additional advantage that they had the first right to partake in the distribution of profits up to the limit of $5 per share per annum, and if necessary, the whole amount of the profits might be taken for that purpose, even if thereby the other stockholders were excluded. We agree with the conclusion of the learned Court below, that the holders of preferred stock are entitled to have the arrears paid to them by the defendant company, without any deduction on account of dividends paid at a time when there had been no deficit. In so far as the excess of such payments over the 10 per cent. per annum to the preferred stockholders was concerned, it was declared not as a matter of preference, but as an equal distribution to all stockholders."

The case of *Sternbergh* v. *Brock,* 225 Pa. St. 279, involved a slightly different question, but the same principle was involved, and the Court followed the same general rule. Preferred stock had been issued in 1899 by the American Iron & Steel Company, which was entitled

> "to receive a cumulative yearly dividend of five per cent. payable quarterly on the first days of January, April, July, and October, in each year before any dividends shall be set apart or paid on the common stock; (b) to be paid in full both principal and accrued dividends in the event of liquidation or dissolution of the company before any amount shall be paid to the holders of the common or general stock; * * *."

From 1899 until 1907 5% was paid on the preferred stock. In 1905 and 1906 a dividend of more than 5% was paid to the common stockholders. In 1907 a quarterly dividend of 2% was declared on all the stock both common and preferred. A common stockholder sought to enjoin the declaration of a dividend greater than 5% to the preferred. The Court refused the injunction. The Court said on page 286:

> "Where there is no stipulation to the contrary, the weight of authority clearly favors the right of preferred stockholders, to share with the common stockholders, in all profits distributed, after the latter have received an amount equal to the stipulated dividend on the preferred stock.
>
> "'In the absence of special provisions, the holders of preferred stock in a corporation are in precisely the same position, both with respect to the corporation itself and with respect to creditors of the corporation, as the holders of common stock, except only that they are entitled to receive dividends on their shares, to the extent guaranteed or agreed upon, before any dividends can be paid to the holders of common stock': *2 Clark & Marshall on Priv., Corp.* (1901), Sec. 417c."

In the case of *Sterling* v. *H. F. Watson Company,* 241 Pa. St. 105, the preferred stock certifi-

cate of the H. F. Watson Company contained the following clause:

> "The stock represented by this certificate is a portion of the preferred stock authorized by the stockholders, in pursuance of the Acts of Assembly of April 18, 1874, P. L. 61; April 3, 1872, P. L. 37, and April 28, 1873, P. L. 79, is entitled to cumulative semi-annual dividends of four per cent. each on the par value of the stock, payable from the net earnings of the company; and is subject to the right of the H. F. Watson Company, at its option, to retire and extinguish the same, upon the payment to the owner thereof all arrears of dividends, and the par value thereof, at any time after April 6, 1907."

The Company declared a stock dividend of 25% payable to both common and preferred stockholders. Later the Company resolved to redeem the preferred stock by paying the par value and accrued dividends less the par value of the 25% stock dividend which had been declared eight years before. This deduction was enjoined. The Court said at page 110:

> "The fact that a stock dividend of 25 per centum of the issue then outstanding was declared and the stock thus issued divided between the common and preferred shareholders according to their respective holdings has no bearing on the question involved in this controversy. Whether this be regarded as a gratuity to all stockholders, or as representing the value of current assets, makes no difference so far as the right of the preferred shareholders to demand as a preference payment of their dividends at the rate of 4 per centum semi-annually out of the net earnings. This was a preference to which these shareholders were entitled under

their contract, and before the preferred stock is retired these dividends must be paid as provided in the certificates. It was so stipulated in the contract with the preferred shareholders, and they have the right to insist upon performance according to the terms of that contract. These dividends are preferences and not limitations. When the preferred dividends are paid, and dividends out of the net earnings from year to year of an equal amount have been declared and paid on the common stock, then all of the stock, common and preferred, has the right to participate in the distribution of surplus earnings upon an equal basis."

* * * * *

"The principle is sound and is sustained by the great weight of authority. We agree with the learned Court below that in principle these cases rule the one at bar. In the present case appellant corporation distributed among all of its stockholders an additional issue of stock, and in the division of this stock no distinction was made between common and preferred shareholders, but this was a matter for the stockholders to determine in the issue of the new stock and it in no way affected the preference in the payment of semi-annual dividends to which the preferred stock was entitled. That the new stock was not issued as a preference to preferred shareholders is shown by the fact that it was distributed to holders of common and preferred stock alike according to their respective holdings."

In the case of *Englander* v. *Osborne*, 261 Pa. St. 366, the preferred stock certificate of the Hoffman, De Witt & McDonough Company provided:

"The holders of the preferred stock shall be entitled to receive when and as declared and the company shall be bound to

pay a fixed yearly cumulative dividend of six per cent. (6%) payable quarterly, before any dividend shall be set apart on the common stock."

No dividends had been paid for nine years. The Company declared a dividend of 54% on both the preferred and common stock. A preferred stockholder obtained an injunction against the payment of this dividend to the common, the Court holding that after the preferred had received their cumulative dividends the common was entitled to 6% only, and that any further dividend must go equally to both common and preferred. The Court said at page 369:

"The priority of the preferred stockholders rests upon the contract and beyond the provisions of such contract they occupy no position toward the company different from that of the holders of common stock. When a dividend is declared the former are entitled to first claim to the extent of their preference for the current year and if there remains a sum more than sufficient to pay a similar dividend on the common stock, both classes of stockholders are entitled to share equally in the excess. In absence of agreement, express or implied, that dividends shall be cumulative, unpaid dividends in the past cannot be claimed: 10 Cyc. 573.

"Likewise there is no logical reason for holding that common stockholders are entitled to go back of the current year, and claim to be reimbursed for unearned dividends in past years. To do so would render such dividends cumulative in effect without agreement. Accordingly, when during previous years no dividends were earned this was conclusive as to the right of all stockholders, both preferred and common, except for the contractual right

> of the former to payment out of future profits to the extent of their preference before the latter would be entitled to participate in the earnings. So far as the holders of the common stock were concerned their status was finally determined when, during any current year, there were no profits to be divided. The profits so lost are lost forever, and each new year marks the beginning of a new dividend paying period: * * *"

These cases set out a clear, logical and consistent rule that the preferred and common stockholders are entitled to share equally in all assets of the corporation, whether such assets be capital, unearned increment, or current or accumulated earnings, except in so far as such assets are otherwise expressly disposed of by the charter or stock certificate, and that no limitation upon the participation of the preferred stock will be implied.

The fact relied upon in the brief for the Prosser Committee (p. 82), that the preferred stocks considered in most of these Pennsylvania cases were cumulative, adds rather than detracts from their force as precedents in the Reading case. As already indicated in point I of this Argument, participation in assets is really essential to the security and soundness of a non-cumulative preferred stock such as the Reading. Without such participation dividends which are passed are lost to the preferred stock forever and go to the enhancement of the value of the property, which would inure to the benefit of the common stock to the exclusion of the preferred. On the other hand, in the case of cumulative preferred stocks, participation in assets is wholly unnecessary for the soundness of the security, although of course, desirable if obtainable as part of the terms of the original issue.

III.

The law of Pennsylvania, as settled by the decisions of the Supreme Court of Pennsylvania, was properly followed by the District Court in the construction of the contract between the Reading Company and its stockholders and between the stockholders *inter sese*.

The Pennsylvania cases were properly followed by the Court below in construing the contract between the Reading Company, a Pennsylvania corporation, and its stockholders. There is only one contract, the same for all stockholders of the Reading Company. That contract has one very clear meaning under the Pennsylvania decisions. It would be very unfortunate if the Federal courts were to undertake to construe a contract between a corporation and its stockholders differently from the State courts. The Federal courts would not, of course, undertake to construe a charter granted by the Commonwealth of Pennsylvania differently from the State courts. If the Federal courts were to attempt to do so the effect would be that the judicial branch of the Federal Government was enlarging or curtailing the powers granted to a corporation by a sovereign act of the State. *Equitable Life Assurance Society of the United States* v. *Brown*, 213 U. S. 25; *First National Bank of Ottawa* v. *Converse*, 200 U. S. 425; *Sioux City R. R. Company* v. *N. A. Trust Company*, 173 U. S. 99; *Black et al.* v. *Zacharie & Company*, 3 How. 483.

In *Equitable Life Assurance Society* v. *Brown*, 213 U. S. 25 the complainant, a policy holder of the defendant Insurance Company, alleged that under the charter of the defendant and the provisions of his policy, the defendant was trustee of its surplus for its policy holders and not for its stockholders. This Court in deciding that no trust for the policy holders existed looked to the New York cases construing the charter and policy of the defendant, saying at page 43:

> "Before discussing the merits of the case it is also proper to first decide what force is to be given the decisions of the highest court of New York with reference to the construction of the charter of the defendant and the policy of insurance issued by it. *Greeff* v. *Equitable Life, &c.*, 160 N. Y. 19. Although the charter was obtained under a general law of the State of New York relating to the incorporation of insurance companies, yet the construction to be given that act and the charter obtained in pursuance of it pertains to the state courts just as if the charter were granted by a special act of the legislature. Ever since its incorporation under the general law of the State of New York, in 1859, the defendant has always done business and had its general home office and its legal residence and domicil in that State. The insurance policy owned by the complainant appears on its face to have been executed in New York and there is no averment to the contrary. The decisions of the highest court of New York are therefore binding upon this court as to the meaning and effect of the charter of the defendant, and as it is a New York company and the contract is a New York contract, executed and to be carried out therein, its meaning and construction as held by the highest court of the State will be of most persuasive influence, even if not of binding force, in the

absence of any Federal question arising in the case. There is no such question here. *Stone* v. *Wisconsin*, 94 U. S. 181, 183; *Park Bank* v. *Remsen*, 158 U. S. 337, 342; *Sioux City &c. Co.* v. *Trust Co.*, 173 U. S. 99. This principle has been so frequently decided that further reference to adjudged cases need not be made."

In *First National Bank of Ottawa* v. *Converse*, 200 U. S. 425, the question was whether a Minnesota corporation was a manufacturing corporation and so whether the stockholders of the corporation were exempt from a "double liability statute." The court followed the state court, saying, at page 438:

"Accepting this construction given by the Supreme Court of Minnesota to the articles of association by which alone the incorporators under those articles can be taken out of the exemption accorded by the constitution of Minnesota, it follows that the thresher company was organized to embark in the purely speculative business of buying and selling the stock and assets of an existing and insolvent corporation, with power, but without the obligation, to engage as an independent enterprise in a manufacturing business."

In *Sioux City Railroad Company* v. *N. A. Trust Company*, 173 U. S. 99, an Iowa corporation had issued bonds in excess of two-thirds of the paid-up capital stock of the company, the limit contained in its charter pursuant to statute. The Supreme Court of Iowa had frequently held that the fact that an Iowa corporation contracted debts in excess of its charter limitation did not render the debt void, but merely gave rise to an action on the part of the state. This Court said at page 112:

"Whether, as an independent question, if we were enforcing the Iowa statute, we

> would decide that the issue of stock by a corporation in excess of a statutory inhibition was not void but merely voidable, need not be considered, since, as we have said, in applying an Iowa law, we follow the settled construction given to it by the Supreme Court of that State."

In *Black et al.* v. *Zacharie & Company*, 3 How. 483, shares of stock in two Louisiana corporations belonging to a citizen of South Carolina were attached in a suit by a creditor in the Federal court in Louisiana. The stockholder had previously assigned the attached stock by a trust deed for the benefit of his creditors. Mr. Justice Story said at page 511:

> "We admit, that the validity of this assignment to pass the right to Black in the stock attached depends upon the law of Louisiana and not upon that of South Carolina. From the nature of the stock of a corporation, which is created by and under the authority of a state, it is necessarily, like every other attribute of the corporation, to be governed by the local law of that state, and not by the local law of any foreign state. And in the present case, if the local law of Louisiana had prohibited: (as we think it had not) any assignment of an equitable interest in the stock attached, *we should not have scrupled to have followed that law.* * * *
>
> "Out of Louisiana, we believe that no such question could possibly arise; for courts of law, as well as courts of equity, are constantly, in all states where the common law prevails, in the habit of holding a prior assignment of the equitable interest in stock as superseding the rights of attaching creditors, who attach the same with a full knowledge of the assignment.
>
> *"Upon full examination of the laws of Louisiana and the decisions of its courts,*

> we see no reason to believe that a different doctrine on this subject prevails in that state." (Italics ours.)

This opinion was written by Mr. Justice Story whose opinion in *Swift* v. *Tyson*, 16 Pet. 1, established the rule that in matters of general jurisprudence the Federal courts are not concluded by the decisions of State courts.

The appellants have cited the following cases: *Kuhn* v. *Fairmont Coal Company*, 215 U. S. 349; *Beutler* v. *Grand Trunk Junction Railway Company*, 224 U. S. 85, 88; *Lane* v. *Vick*, 3 How. 464; *Foxcroft* v. *Mallett*, 4 How. 351, 359; *Swift* v. *Tyson*, 16 Pet. 1; *Carpenter* v. *Providence Washington Insurance Company*, 16 Pet. 495, 511; *Aetna Life Insurance Company* v. *Moore*, 231 U. S. 543; *Burgess* v. *Seligman*, 107 U. S. 20; *Clark* v. *Bever*, 139 U. S. 96.

The first seven of these cases have nothing to do with the binding force of a State court's decisions affecting corporations created by act of the State. In the other two cases the State court decisions which the Federal courts did not follow were rendered after the litigation in the Federal courts had begun.

Every consideration of public policy and of comity supports the view that the Federal courts should, in construing the charter and act of incorporation and stock certificates of a corporation, follow the decisions of the courts of the State which created the corporation. The decision of the Court below to follow the Pennsylvania decisions was entirely proper and in conformity with sound precedents and does not furnish a basis for appeal.

IV.

The authorities relied upon by the appellants dealing with the rights of stockholders *inter sese* are from jurisdictions foreign to Pennsylvania and are distinguishable from the present case.

The following cases, most of them from jurisdictions other than Pennsylvania, are those chiefly relied upon by counsel for the appellants, to prove that the common stockholders are exclusively entitled to the right to subscribe to certificates of interest in the stock of the new corporation. *The Equitable Life Assurance Society of the United States* v. *Union Pacific Railroad Company*, 212 N. Y. 360; *Scott* v. *The Baltimore and Ohio Railroad Company*, 93 Md. 475; *Stone* v. *United States Envelope Company*, 119 Me. 394; *Russell* v. *American Gas and Electric Company*, 152 App. Div. (N. Y.) 136; *Niles* v. *Ludlow Valve Mfg. Company*, 196 Fed. Rep. 994, 202 Fed. Rep. 141; *Will* v. *United Lankat Plantations Company*, 106 L. T. Rep. (N. S.) 531, [1912] 2 Ch. 571, [1914] A. C. 11; *St. John* v. *Erie R. R. Company*, 22 Wall. 136; *Keith* v. *Carbon Steel Company* (U. S. Dist. Ct., W. Dist., Pa. not reported.)

(a) The Union Pacific Cases.

The Equitable Life Assurance Society of the United States v. *Union Pacific Railroad Co.*, 212 N. Y. 360. The Union Pacific Railroad Company had declared a dividend to the common stockholders exclusively, consisting of (1) three dollars

in cash; (2) twelve dollars par value of preferred stock of The Baltimore and Ohio Railroad Company; (3) twenty-two and a half dollars par value of the common stock of The Baltimore and Ohio Railroad Company. The regular dividend on the common stock was at the same time reduced from ten per cent. to eight per cent., the reduction being the exact equivalent of the income value of the extraordinary dividend.

The Union Pacific stock certificates provided:

> "The holders of Preferred Stock shall be entitled, in preference and priority over the Common Stock of said Company, to dividends in each and every fiscal year at such rate *not exceeding 4 per cent. per annum*, payable out of the net profits as shall be declared by the Board of Directors.
>
> "Such dividends are non-cumulative *and such Preferred Stock is entitled to no other or further share of the profits.*" (Italics ours.)

A preferred stockholder sought to enjoin the payment of this dividend to the common stock exclusively, but it was held that this was a dividend declared out of profits, that the preferred stockholders by the express terms of the stock certificates having received four per cent. dividends were entitled to no other or further share of the profits, and that the dividend was properly declared to the common stockholders. The distinguishing factor is that the Union Pacific preferred stock certificates expressly provided that *"such Preferred Stock is entitled to no other or further share of the profits."* As the Court found that the dividend in that case was declared out of profits, the express language of the certificate controlled its decision. That language was perfectly clear and was broad enough

to exclude the Union Pacific preferred stock from any share of the profits whether by way of dividends or otherwise and whether in the ordinary course of business or upon the liquidation or dissolution of the corporation. The Reading preferred stock certificate, on the other hand, contains no preference or limitation, expressly or by implication, except as to participation in current dividends.

Moreover, the decree in the Reading case involves the involuntary separation from the Reading Company of what was an integral part of the business for which it was recreated in connection with the reorganization of 1896. (See point IX of this Argument.) This distinguishes the Reading case in a most marked way from the *Union Pacific* case. The larger part of the Union Pacific holdings of Baltimore and Ohio stock had been acquired in exchange for Southern Pacific stock in connection with the dissolution of the Union Pacific-Southern Pacific combination less than a year before the dividend was declared. Though the Union Pacific Railroad Company was forced to sell its Southern Pacific stock (which as a matter of fact it did sell to its preferred and common stockholders *pro rata*), it was not forced to sell its holdings of Baltimore and Ohio stock or to dispose of them in any way, for the legality of its ownership of the Baltimore and Ohio stock had not been questioned. The Union Pacific parted with its holdings of Baltimore and Ohio stock voluntarily by way of dividend. There were not in that case any of the elements relied upon in the present case in support of the Plan.

The case of *United States* v. *Union Pacific Railroad Company*, 226 U. S. 61, 470, referred to in the Plan (Record, pp. 43, 275) as the Union

Pacific-Southern Pacific case, was relied upon by the Reading Company in support of its affirmative answer to the following question (not in issue on these appeals) submitted by the District Court among other questions for argument in its order filed April 12, 1921 (Record, p. 206):

> "Whether the sale provided for in paragraph Five of the Reading Plan is such a disposition of the interest of Reading Company in the stock of The Philadelphia & Reading Coal & Iron Company as accomplishes the express purpose of the mandate of the Supreme Court of the United States requiring disposition by Reading Company of such stock because the holding of it has been and would be unlawful."

Although in fact the Union Pacific did sell its Southern Pacific stock or a portion thereof to its stockholders, preferred and common, share and share alike, that case has no bearing one way or another upon the question at issue upon these appeals, for the Southern Pacific stock was sold at or about its market value.

(b) The Baltimore and Ohio Case.

Scott v. *The Baltimore and Ohio Railroad Company*, 93 Md. 475. The preferred stock certificate of the Baltimore and Ohio provided:

> "The holders of Preferred Stock * * * are entitled to receive in each year out of the surplus net profits of the Company for the current year, such yearly dividend (non-cumulative) as the Board of Directors of said Railroad Company may declare, up to but not exceeding four per centum, before any dividends shall be set apart or paid upon the Common Stock."

The only question involved in this case was the right of the preferred stockholders to divi-

dends in excess of four per cent. out of the current earnings of each fiscal year. No question was involved as to the right to share in accumulated earnings or in capital accretion. This is clearly shown by the pleadings in the Circuit Court of Baltimore City.

The court held that the preferred stockholders were only entitled to 4 per cent. out of the net earnings for the current year and that the Baltimore and Ohio could lawfully pay dividends from current earnings in excess of 4% on the common stock without participation by the preferred. This decision is in accord, therefore, with the theory and practice of the Reading Company under which the preferred stockholders of the Reading Company are only entitled to 4 per cent. from current surplus net earnings, though dividends therefrom are paid at a higher rate on the common stock.

The rights of preferred stockholders in accumulated earnings or accretions to capital were not involved in the case, and any expression of opinion about such rights was *dictum*.

(c) Cases of preferred stocks expressly preferred as to assets.

In the following cases the preferred stocks were all by express provision preferred as to assets. In the Reading case there is no preference as to assets, and these cases do not in any way qualify the proposition, which is elementary, that such a stock as the Reading, which contains no express provision one way or the other, is neither preferred nor limited as to assets.

Stone v. *United States Envelope Company*, 119 Me. 394. This case involved an issue of additional stock by the defendant company whose

preferred stock was preferred by its terms both as to dividends and assets. The Maine Court stated that the Pennsylvania rule was not in accord with its decision, saying at page 396:

> "There are two opposing theories, each of which has judicial support. One theory is that the preferred stockholder presumptively yields nothing in compensation for the benefits which he receives; that he has and holds all the rights of the common shareholder and in addition has his preferential rights.
>
> "Upon this theory the defendant relies, and in support of it cites *Jones* v. *Railroad Co.*, 67 N. H. 234, 30 Atl. 614, 68 Am. St. Rep. 650 (1892), and a series of cases in Pennsylvania, the latest of which, *Englander* v. *Osborne*, 261 Pa. 366, 104 Atl. 614, 6 A. L. R. 800, affirms the earlier decisions.
>
> "Clark & Marshall on Corporations and also Cook (6th Ed.) are cited by the defendant. These works were written and published before the cases of *Niles* v. *Ludlow Valve Mfg. Co.* and *Will* v. *U. L. P. Co., infra,* were decided. But even the sixth edition of Cook says that 'the question is an open one.' Section 269, p. 1.
>
> "The other theory, which we believe to be better and supported by the weight of authority, is that, in receiving the greater security of his preferential rights, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation."

Russell v. *American Gas and Electric Company*, 152 App. Div. (N. Y.) 136. The preferred stock of the defendant corporation was entitled by its terms to cumulative dividends and to preference in the distribution of assets until the par value and accumulated dividends had been paid and "to no further dividend or *distribution*." The corpora-

tion offered the right to subscribe to an issue of common stock to the common stockholders to the exclusion of the preferred. A preferred stockholder sought to enjoin the issue unless the preferred stockholders were also given the right to subscribe. The Court held that the preferred stockholders were not entitled to share in the right to subscribe.

Niles v. *Ludlow Valve Mfg. Company,* 196 Fed. Rep. 994, 202 Fed. Rep. 141. This case involved the issue of additional stock by a New Jersey corporation. The preferred stock was preferred by its terms as to assets as well as dividends, and was held to have no right to participate in this issue.

The real basis of these three decisions is that where preferred stockholders are preferred and limited as to assets, their interest in the assets of the corporation is not affected by the issue of additional common stock, since they are entitled only to the par value of their stock from assets, the balance belonging to the common. This is clearly recognized in the opinion of Judge Hough in *Niles* v. *Ludlow Valve Mfg. Company,* in which he says:

> "It is, I think, true that underlying the question on the surface of this case is the inquiry: What would have been the rights of the preferred shareholders, had this company gone into involuntary dissolution with a large accumulation of earnings in its treasury, so that after paying every shareholder, whether common or preferred, 100 cents on the dollar, this surplus would still have remained."

In *Russell* v. *American Gas and Electric Company,* the preferred stock was by its terms not only preferred but also limited as to assets, and this

decision is not contrary to the Pennsylvania rule. The doctrine in Pennsylvania differs from the doctrine in the other two cases, to this extent and this extent only, that in these cases the Courts hold that an express preference carries with it by implication a corresponding limitation; while the Pennsylvania Courts hold that a limitation must be equally express and cannot be implied from an express preference. None of the cases cited on behalf of the appellants in any way detracts from the doctrine established by the House of Lords in *Birch* v. *Cropper*, 14 A. C. 525 (the *Bridgewater* case), by the New Hampshire Court in *Jones* v. *Concord & Montreal Railroad Company*, 67 N. H. 119, 234, and by the New Jersey Court in *Lloyd* v. *The Pennsylvania Electric Vehicle Company*, 75 N. J. Eq. 263 (discussed in point VIII of this Argument), that, in the absence of any express preference or limitation as to assets, preferred and common stocks share equally in assets. No case has been found in any jurisdiction in which a limitation as to assets has been implied from a preference as to dividends. In the *Lloyd* case it was expressly said that a preference as to dividends did not imply either a preference or limitation as to assets (point VIII, p. 62 of this Argument).

The Reading stock certificates contain no preference as to assets, and therefore under either rule there is no limitation as to assets.

Will v. *United Lankat Plantations Company*, 106 L. T. Rep. (N. S.) 531, [1912] 2 Ch. 571, [1914] A. C. 11. The company declared a dividend payable only to the common stockholders in the shares of another company which it had received in payment for certain property. The preferred stockholders claimed the right to participate in this

dividend. The preferred stock had been created after the company had been engaged in business for two years, and was preferred as to both dividends and assets. The original articles of associations provided in Article 115:

> "Subject to any priorities that may be given upon the issue of any new shares, the profits of the company available for distribution * * * shall be distributed as a dividend among the members in accordance with the amounts paid on the shares held by them respectively."

After the issue of the preferred shares, but prior to the declaration of this dividend the following Article had been substituted for Article 115:

> "Subject to any priorities that may be given upon the issue of any new shares, or may for the time being be subsisting, the profits of the company available for distribution shall be applied first in payment of a cumulative dividend at the rate of 10 per cent. per annum upon the amounts paid on the original preference shares of the company, and subject thereto shall be distributed as dividend among the holders of the ordinary shares in accordance with the amounts for the time being paid on the ordinary shares held by them respectively, other than amounts paid in advance of calls."

The House of Lords treated this question as one of construction, and held that Article 115, as amended, controlled and that therefore the preferred stockholders by its express terms were limited to their preferred dividend.

The *Bridgewater* case represents the law in England applicable to the Reading situation (See point VIII, p. 59).

(d) Miscellaneous.

St. John v. *Erie R. R. Company,* 22 Wall. 136. This case involved no question as to the rights of stockholders *inter sese.* Holders of preferred stock entitled by its terms to a preferred dividend out of net earnings for the current year, if earned, not exceeding seven per cent, claimed to be absolutely entitled to receive this dividend, if earned, even though the earnings were insufficient also to pay rental under leases entered into after the creation of the preferred stock. In other words, the preferred stockholders claimed that they should be treated as preferred creditors, but the Court did not sustain this contention. The language quoted from this case in the brief for the Prosser Committee (pp. 41, 61) has no reference to the questions now under consideration.

Keith v. *Carbon Steel Company* (U. S. Dist. Ct., W. Dist. Pa., not reported). In this case the preferred dividend, and a like dividend to the common stock had been paid and an extra dividend from earnings from the current year was declared to the common stockholders. A preferred stockholder claimed the right to share in this dividend, but the Court held that the common stock was exclusively entitled to it. (The opinion is printed in full as an appendix to the brief for the Insurance Companies). This case is, of course, of no authority on the questions presented on these appeals, since it only decides that the preferred stockholders were not entitled to a dividend from current net earnings in excess of the limitation prescribed by the stock certificate. This has been the interpretation put upon its own stock certificates by the Reading Company for many years. The appellants point out that the decision was rendered by the Federal Court for the Western

District of Pennsylvania, but fail to mention that it concerned stock of a West Virginia corporation. West Virginia law, therefore, and not Pennsylvania law was the law governing the construction of this contract between the corporation and its stockholders, and this was recognized by the Court.

V.

The other authorities relied upon by the appellants are not applicable to the facts of this case.

(1) The brief for the Insurance Companies, (pp. 67 ff), cites the following cases to show that even if the transaction is a sale it is void because made to controlling stockholders for an inadequate consideration: *Southern Pacific Company* v. *Bogert,* 250 U. S. 483; *Mason* v. *Pewabic Mining Company,* 133 U. S. 50; *Wardell* v. *R. R. Company,* 103 U. S. 651; *Twin-Lick Oil Company* v. *Marbury,* 91 U. S. 587; *Backus* v. *Brooks,* 195 Fed. Rep. 452; *Jones* v. *Missouri Edison Electric Company,* 144 Fed. Rep. 765; *Rothchild* v. *Memphis & C. R. Company,* 113 Fed. Rep. 476; *Mumford* v. *Ecuador Development Company,* 111 Fed. Rep. 639; *Rogers* v. *Nashville C. & St. L. Ry. Company,* 91 Fed. Rep. 299; *Ervin* v. *Oregon Ry. & Navigation Company,* 27 Fed. Rep. 625; *Mecker* v. *Winthrop Iron Company,* 17 Fed. Rep. 48.

With the exception of *Mason* v. *Pewabic Mining Company,* 133 U. S. 50, which is discussed below, these cases deal with transactions in which it was alleged that majority stockholders had ex-

ercised their control of the corporation so as to transfer all or a large part of its assets for an inadequate consideration to another corporation in which the minority stockholders had no interest at all or that directors had contracted with the corporation for their own benefit. They are based upon a breach of duty to the corporation by directors for their own benefit or the fraud of the majority stockholders in exercising their control of the corporation for their benefit to the exclusion of the minority stockholders.

In the present case the certificates of interest in the stock of the new coal corporation are to be disposed of to all the stockholders, preferred and common, share and share alike. The only question is whether the appellants, representing a minority of the common stock, shall prevail in their contention that the holders of the preferred stock should be excluded from participation in such benefits as may accrue to those having the right to subscribe for certificates of interest in stock of the new coal corporation.

In *Mason* v. *Pewabic Mining Company*, 133 U. S. 50, the charter of the defendant corporation had expired and instead of liquidating the business, the majority stockholders voted to sell all its property supposedly worth $500,000 to a new corporation for $50,000, shares in the new corporation to be issued in exchange for shares of the old corporation, with the option to any stockholder to receive instead of stock in the new corporation his pro rata share of $50,000 in cash. An injunction was granted on the ground that the majority stockholders could not force the minority to take stock in the new corporation, in the future of which they might have no confidence, or to accept for their stock a value arbi-

trarily fixed by the majority. (See *Geddes* v. *Anaconda Mining Company*, 254 U. S. 590, 601). It is obvious that no such question is involved in these appeals.

(2) Income tax cases: *United States* v. *Phellis*, No. 260, October Term, 1921; *Rockefeller* v. *United States*, No. 535, October Term, 1921; *New York Trust Company* v. *Edwards*, No. 536, October Term, 1921.

These cases involved the question whether the stock distributed constituted income under the provisions of the Revenue Act of October 3, 1913, Chap. 16 (38 Stat. 114, 166, 167), that income shall include gains derived "from interest, rent, dividends, securities, or * * * gains or profits and income derived from any source whatsoever."

It is conceded that the right to subscribe for certificates of interest in the stock of the new coal corporation is a valuable right. Just how valuable, is undetermined. The question presented by these appeals is not whether the disposition made of the coal property is a dividend or income within the meaning of the income tax law, but whether, in the light of the facts, of the contract embodied in the stock certificates and of the decided cases, the disposition so made comes within the rule governing current dividends or, as believed by the Reading Company, within the rule governing the disposition of assets.

(3) Since the question presented by these appeals is that stated in the preceding paragraph, the following cases cited by the appellants are irrelevant: *Hartley* v. *Pioneer Iron Works*, 181 N. Y. 73; *Smith* v. *Moore*, 199 Fed. Rep. 689; *Grants Pass Hardware Company* v. *Calvert*, 71 Or. 103; *In re Wilson's Estate*, 85 Or. 604; *City of Allegheny* v. *Pittsburgh, A. & M. P. R. R. Com-*

pany, 179 Pa. St. 414; *Wilder* v. *Tax Commissioner,* 234 Mass. 470.

(4) The brief for the Insurance Companies, (pp. 29 ff) cites a number of cases most of which deal with the rights of creditors to recover from stockholders unpaid subscriptions to stock or corporate property improperly distributed, or with the distinction between the phrases "capital," "capital stock" and "shares of stock," and have no connection with the present case. The remaining cases (*Alabama Consolidated Coal & Iron Company* v. *Baltimore Trust Company,* 197 Fed. Rep. 347; *Excelsior Water and Mining Company* v. *Pierce,* 90 Cal. 131; *Hubbard* v. *Weare,* 79 Iowa 678; *Williams* v. *The Western Union Telegraph Company,* 93 N. Y. 162; *Bassett* v. *U. S. Cast Iron Pipe and Foundry Company,* 74 N. J. Eq. 668; *Lubbock* v. *British Bank of South America* [1892] 2 Ch. 198) discuss, from various points of view, the power of directors to treat the assets of a corporation in excess of liabilities and capital stock as surplus available for distribution to stockholders. These cases have no bearing on the present question, since it is not disputed that, as a matter of law, and in the absence of special restrictions, directors may distribute surplus among the stockholders entitled to share therein.

VI.

Considering the character of the action taken, of the asset disposed of, and of the surpluses affected, there are present in the situation none of the elements necessary to bring it within the rule governing current dividends.

The Plan contemplates and the Decree directs a sale of the interest of the Reading Company in the coal property. The price which the Reading Company will receive for the coal property and the selling price of the certificates of interest in the stock of the new corporation to be created pursuant to the Decree were fixed with regard to the requirements of the Reading Company (Record, p. 163). The Plan provides for immediate disposal of the Reading Company's beneficial interest in the coal property. That having been accomplished, it makes the stockholders of the Reading Company a conduit for the transmission of the ownership of the certificates of interest to persons not stockholders in the Reading Company. So great a property as that of the Coal Company cannot, under the peculiar general conditions now existing, and under the peculiar special conditions affecting the Reading coal property, be advantageously sold at this time or in bulk (Record, p. 163). The Plan is not only advantageous from the point of view of prompt compliance with the Mandate of this Court, in that it immediately divests the Reading Company of all ownership and control of the Coal Company, but is also ad-

vantageous to the stockholders of the Reading Company, in that it gives them the benefit of the hope that they may realize more for the property than the Reading Company itself could realize for it in the event of a direct sale (Record, p. 163).

The determination of the question presented on these appeals would not have been avoided by the sale of the stock of the new corporation to outsiders for the best price obtainable. That question was inherent in the situation created by the Mandate of this Court ordering the dissolution of the combination existing and maintained through the Reading Company, and directing that its property be disposed of. The sale to outsiders under the circumstances referred to would have resulted in sacrificing the interests of all the stockholders; and the proceeds of sale would have taken the place of the certificates of interest in the stock of the new corporation as the subject-matter of the controversy.

The stock of the Coal Company is a capital asset, and not in any sense earnings or profits of the Reading Company. It was acquired by the Reading Company in 1896, as part of the consideration for the issue of the present outstanding stocks and bonds (Record, p. 160), and the present book value to the Reading Company of its investment in the coal property is not materially greater than it was at the time of such acquisition (Record, p. 162).

Nor is the book surplus of the Coal Company earnings or profits of the Reading Company. *Pardee* v. *Harwood Electric Company*, 262 Pa. St. 68; *United States Trust Company of New York* v. *Heye*, 181 App. Div. 544; 224 N. Y. 242 (a case growing out of the Standard Oil dissolution).

The statement of working assets and current

liabilities of the Reading Company as of December 31, 1920 (Record, p. 202) shows that it was not in a position to make any extraordinary distribution of current profits, and the sale of the coal property does not result in a profit to the Reading Company.

The capital and surplus of the Reading Company will be protected under the Plan by carrying into its books the surplus of the Railway Company which is more than sufficient to counterbalance the loss on the sale of the coal property (Record, p. 169). This is significant in connection with the suggestion of the Prosser Committee in their intervening petition (Record, p. 109) repeated in their brief in this Court (p. 21), that the capital stock of the Reading Company should be reduced. If there were any risk of impairment of capital, or even of such curtailment of surplus as to imperil future dividends, that fact in itself might be a valid objection to the Plan.

Though the surplus of the Railway Company will thus serve to protect the capital and replenish the surplus of the Reading Company, the surplus of the Railway Company is not in fact in such shape as to suggest or indeed, as a matter of sound corporate management, to justify any extraordinary dividend distribution. This is shown by the statement of the working assets and the current liabilities of the Railway Company as of December 31, 1920 (Record, p. 202). The annual report of the Railway Company for the year ending June 30, 1910, contains the following statement (Record, p. 172):

> "By command of the Interstate Commerce Commission, we are required to capitalize all betterments and additions which

have been paid for out of income since June 30, 1907.

"The line drawn between renewals and repairs chargeable to Expense Account and Improvements is forcibly illustrated by the ruling on replacements of rails in tracks. If the old rail weighed sixty pounds and the new weighs ninety pounds, one-third of the cost of the new rail must be capitalized. The item on the assets side of the Balance Sheet, amounting to $4,814,042.76 is the result of the Commission's order. With no counter entry on the liability side of the Balance Sheet, this sum would go to increase 'Profit and Loss.' Some of the railroad companies accept this result. It swells their surplus and has the appearance of wealth. But it seems to your management both misleading and dangerous. Increasing 'Profit and Loss' in this way will again tempt, as it has done in the past, the declaration of large stock dividends, thereby swelling capital on which earnings are to be made. To prevent misleading investors and stockholders, we have decided not to include this in 'Profit and Loss,' but to make the counter entry on the Balance Sheet: 'Appropriated surplus; expenditures on property since June 30, 1907, and charged as an asset.'"

This practice has been continued and the balance sheet of the Railway Company for December 31, 1920 (Record, p. 200), shows the following items:

Additions to Property Through Income and Surplus.....	$53,451,156.59
Profit and Loss.....	10,276,169.32

VII.

The surplus of the Reading Company does not belong to the common stockholders under the circumstances here obtaining.

Though the investment in the coal property is part of the original enterprise and its book value to the Reading Company today does not materially exceed that upon the reorganization in 1896 (Record, p. 162), and it is not contended that its market value exceeds its book value (Record, p. 163); though the capital and surplus of the Reading Company would be protected under the Plan (Record, p. 169); though the transaction does not result in a profit (Record, p. 162), and there is no surplus of a character to suggest or indeed as a matter of sound corporate management to justify, an extraordinary dividend (Record, p. 171); nevertheless the appellants claim that, as the transactions contemplated by the Plan necessitate a charge against the surplus of the Reading Company, representing the difference between the book value of the coal property to the Reading Company, and the selling price to the new corporation (Record, pp. 162, 163), therefore whatever benefits may accrue from the transactions should accrue to the common stockholders alone, to the exclusion of the preferred stockholders, for, say the appellants, the surplus of the Reading Company belongs to the common stockholders exclusively under the circumstances here obtaining (Record, p. 107).

But the surplus of the Reading Company does not *belong* to the common stockholders in any sense whatever, and they cannot rightfully object

to a charge being made against surplus in connection with the transaction now contemplated and under the circumstances now presented. All the property of the Reading Company, including its surplus, belongs, subject to the claims of the creditors and the vicissitudes of the business, to all its stockholders, preferred and common, share and share alike, subject to the right of the directors of the Reading Company to declare dividends pursuant to the contract between the company and its stockholders. That contract makes express provision concerning current dividends but no provision concerning the disposition of assets.

The contract is contained in the stock certificates, copies of which are set forth in the Record, pp. 82-93. For convenience the following excerpts therefrom are quoted here. The numbers and italics are ours.

> (1) "The First Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment *in or for such fiscal year* of any dividends on other stock; but only from undivided net profits of the Company when and as determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom."
>
> (2) "The Second Preferred Stock is entitled to non-cumulative dividends at the rate of, but not exceeding, four per cent. per annum, in each and every fiscal year, in preference and priority to any payment *in or for such fiscal year* of any dividend on the Common Stock; but only from undivided net profits of the Company remaining after providing for the payment of the

full dividends for such fiscal year on the First Preferred Stock, when and as such undivided net profits shall have been determined by the Board of Directors, and only if and when the Board shall declare dividends therefrom."

(3) "If, *from the business of any particular fiscal year, excluding undivided net profits remaining from previous years,* after providing out of the net profits of such particular fiscal year for the payment of the full dividends for such fiscal year on the First and Second Preferred Stock, there shall remain surplus net profits, the Board of Directors may declare, and *out of such surplus net profits of such year* may pay, dividends upon any other stock of the Company."

(4) "But no dividends shall in any year be paid upon any such other stock out of net profits of any previous fiscal year in which the full dividends shall not have been paid on the First and Second Preferred Stock."

There is nothing in the contract to substantiate the claim that even current surplus *belongs* to the common stockholders. It does not belong to them. It is subject to the risks of the business and such charges and losses as may occur in the conduct of the business, ordinary or extraordinary. The common stockholders cannot maintain an action for it, nor for the payment of dividends from it, in the absence of bad faith. The right of the common stockholders is limited to this: When the board of directors do declare dividends from current earnings, after providing for the full 4% dividends on preferred stocks, they shall be declared as dividends to the common stockholders exclusively. It has been and will no doubt continue to be the Reading Company's practice when practicable to pay dividends from current

earnings at greater rates than 4% without permitting the preferred stock to participate in such dividends (Record, p. 58). That practice rests not upon any doubtful practical construction but upon the clear provision of the contract. The express grant in the stock certificates (clause 3 above) of authority to the directors, after providing for the full dividend on the preferred, is to *pay* dividends to the common stock out of current surplus net profits remaining (not merely to permit the common stock to *participate* in such dividends).

It is conceded that surplus accumulated in years when 4% dividends were not paid on the preferred stock does not belong to the common stockholders. The contract expressly provides that no dividends shall be paid on the common stock from such surplus (clause 4 above).

As to the right of the board of directors in the ordinary course of business to pay dividends on the common stock to the exclusion of the preferred from surplus accumulated in those years in which full 4% dividends *were* paid on the preferred stocks, a question has been raised on behalf of certain preferred stockholders because of the words which denominate the fund from which the directors may pay dividends on the common stock, to the exclusion of the preferred, as "surplus net profits from the business of any particular fiscal year, excluding undivided net profits remaining from previous years" (clause 3 above). This is a question which the Reading Company has never been called upon to decide, for it has never drawn upon accumulated surplus for dividends on the common stock and in the view of the Reading Company, it is not necessary to decide it now (Record, p. 182).

Whatever may be the rights of the preferred and common stocks in respect of dividends in the ordinary course of business from such accumulated surplus, it does not *belong* to the common stockholders.

The contract makes no express disposition of surplus so accumulated. Naturally, therefore, while part of the undisposed of property of the company, it is subject to the general rule which makes it the property of all the stockholders, preferred and common, share and share alike, available for equal distribution among them, under the circumstances here obtaining; subject, however, to the right of the company, under equitable conditions, to eliminate the preferred stockholders as sharers therein by redeeming the preferred stock at par.

The decision of the board of directors as to the portion of current earnings up to 4% on the preferred stock which shall go to the preferred stock as dividends, and the portion of current earnings, after the payment of dividends of 4% to the preferred stock, which shall go to the common stock is binding, and the surplus net profits, of any year, which the board of directors has not determined to declare out for dividends, become part of the general assets of the Company which, in the case of an extraordinary distribution under the circumstances here obtaining are—as between preferred and common stockholders—subject to no preference but are distributable to them share and share alike, without discrimination and without priority or limitation of right.

As to this the determination of the board of directors is conclusive, and whatever part of the current surplus the board of directors determines

shall be retained as necessary for the conduct of the Company's business or turned back into the property for its betterment or improvement or added to its "plant" in the enlargement of those facilities in which the Company's capital is invested, becomes, by their determination and because of their determination, segregated for capital uses—uses inconsistent with a use for dividend purposes and not subject to the rules applicable to available dividend funds—and its status so lawfully created and with such a wise and prudent purpose cannot be changed without the specific and explicit determination of the board that it shall be so changed.

It cannot be fairly contended that, under the compulsion of a power superior to the Company, forcing the latter to part with a material and important part of its "plant" or its assets segregated for and devoted to capital uses, there has been, or is intended to be, either in fact or in law, any such determination by the board as is required to change that status.

VIII.

The preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation unless they are expressly preferred or limited by the terms of the contract between them.

It is the universal rule that preferred and common stockholders share equally in the event of dissolution or liquidation of a corporation, unless

they are expressly preferred or limited in that respect by the terms of the contract between them. It is well settled that a preference as to dividends does not imply either a preference or a limitation in respect of the right to share equally in assets on liquidation or dissolution. *Birch* v. *Cropper* (*In re The Bridgewater Navigation Company Limited*), 14 A. C. 525 (House of Lords); *Lloyd* v. *Pennsylvania Electric Vehicle Company*, 75 N. J. Eq., 263; *Jones* v. *Concord & Montreal Railroad Company*, 67 N. H. 119, 234.

In *Birch* v. *Cropper* (the *Bridgewater* case), 14 A. C. 525, the company issued stock expressly preferred as to dividends, but not as to assets. The articles of association contained no provision as to the distribution of assets on winding up. The Company was dissolved, and after all debts and expenses had been paid and after repaying to the stockholders the amount of capital paid up, a balance remained. It was held that this should be divided among the shareholders, share and share alike. Lord Macnaghten said at page 546:

> "The ordinary shareholders say that the preference shareholders are entitled to a return of their capital, with 5 per cent. interest up to the day of payment, and to nothing more. That is treating them as if they were debenture-holders liable to be paid off at a moment's notice. Then they say that at the utmost the preference shareholders are only entitled to the capital value of a perpetual annuity of 5 per cent. upon the amounts paid up by them. That is treating them as if they were holders of irredeemable debentures. But they are not debenture-holders at all. For some reason or other the company invited them to come in as shareholders, and they must

be treated as having all the rights of shareholders, except so far as they renounced those rights on their admission to the company. There was an express bargain made as to their rights in respect of profits arising from the business of the company. But there was no bargain—no provision of any sort—affecting their rights as shareholders in the capital of the company."

* * * * * *

"* * * I think it rather leads to confusion to speak of the assets which are the subject of this application as "surplus assets" as if they were an accretion or addition to the capital of the company capable of being distinguished from it and open to different considerations. They are part and parcel of the property of the company —part and parcel of the joint stock or common fund—which at the date of the winding up represented the capital of the company. It is through their shares in the capital, and through their shares alone, that members of a company limited by shares become entitled to participate in the property of the company."

In the case of *Lloyd* v. *Pennsylvania Electric Vehicle Company*, 75 N. J. Eq. 263, preferred stockholders of a New Jersey corporation, preferred only as to dividends, were paid on dissolution the full par value of their stock. The remaining assets were insufficient to pay the common stockholders in full. The court held that the assets should have been divided ratably among the preferred and common stockholders, since, when a corporation undertakes to set forth the preference to which preferred stock is entitled, instead of relying on the preference given by statute, the preference must be set forth fully, and so far as no preference is expressed, the preferred stock can have no greater rights

than the common stock. The Court said, at page 267:

> "Nor is any difficulty presented where the terms of the contract entitle the preferred stockholder to a preference in dividends only. In this case, which, as Vice Chancellor Van Fleet said, and as the authorities show, was the ordinary case in the absence of such a provision as that contained in Section 86, the preferred stockholders and the general stockholders would share *pro rata* in the distribution of assets after the payment of dividends due the preferred stockholders. That such would be the rule is well illustrated by a thoroughly considered case in the English courts * * *" (*Birch* v. *Cropper, supra.*)

In the case of *Jones* v. *Concord & Montreal R. R. Company*, 67 N. H. 119, 234, the railroad company increased its capital stock and offered the new stock at par to all its stockholders ratably. The preferred stockholders were preferred as to dividends but not as to assets. A common stockholder sought to enjoin the company from offering this stock to the preferred stockholders. The Court refused the injunction on the ground that, where there was no express stipulation to the contrary, preferred and common stockholders were equal; that since the railroad company's stock was not preferred or limited as to assets, all classes of stockholders would share equally on dissolution, and that therefore they should have the right to subscribe ratably to an issue of new stock.

These cases are believed correctly to state the law everywhere. The analysis of the cases relied upon by the appellants contained in point IV of this Argument shows that they stand simply for the proposition that a limitation as to assets may be implied from an express preference as to

assets. Neither those cases, nor any other cases which have been found, at all militate against the doctrine clearly established in the cases discussed in this point VIII, that, in the absence of any express preference or limitation as to assets, no limitation as to assets can be implied from a preference as to dividends.

The Pennsylvania cases, cited and discussed under point II, *supra*, show that Pennsylvania follows the general rule in this respect.

IX.

The rights of Reading stockholders, under the Mandate of this Court directing that the combination existing and maintained through the Reading Company be dissolved and that its properties be disposed of, and under the Plan, are determined not by the rule governing dividends from current earnings, but by the rule governing the disposition of assets.

The Decree in this case involved the utter disintegration of the business for which the Reading Company was recreated and its now outstanding stock issued in connection with the reorganization of 1896.

Mr. Justice Clarke said of the scheme of reorganization (Record, pp. 8 and 9):

> "3rd. To serve the purposes of the intended Holding Company, a charter granted in 1871 by special act of the General Assembly of Pennsylvania, but unused for twenty years, was utilized. This char-

ter was of the class denominated 'omnibus' by the Supreme Court of Pennsylvania, and in terms it authorized the company to engage in, or control, almost any business other than that of a bank of issue,—this broad charter was the occasion for making use of the company in this enterprise."

* * * * *

"Obviously, also, it made the Coal Company and the Railway Company mere agents or instrumentalities of the Holding Company—the mining and transportation departments of its business—for producing, purchasing, and selling coal and for transporting it to market."

The Attorney General of Pennsylvania in his opinion dated January 2, 1897 (Record, p. 252) had said:

"Pending the foreclosure proceedings under the general mortgage made by the Philadelphia and Reading Railroad Company and the Philadelphia and Reading Coal and Iron Company, it came to the notice of this department that a plan of reorganization was contemplated, by which it was proposed that the stock of the two companies above mentioned should be held, owned and controlled by the corporation originally known as the Excelsior Enterprise Company, since changed to Reading Company, as above mentioned.

"The obvious purpose of this part of the scheme of reorganization seemed to be to escape from that provision of the Constitution of 1874 which forbids any incorporated company doing the business of a common carrier to directly or indirectly engage in mining or manufacturing articles for transportation over its lines; or, stated differently, the union of the Coal Company with the Railroad Company."

The annual reports for years before the reorganization had emphasized the importance of the unified ownership of the coal and railroad properties. For instance, in the annual report for 1893 it was said (Record, p. 263):

> "For the last quarter of a century the maintenance of the integrity of the Reading System as a whole, and the preservation of the franchises of both the railroad and coal and iron companies so as to develop and operate the properties of both companies to advantage, have been regarded as of cardinal importance to all interested, either as creditors or as stockholders."

The Reading Company, although chartered in 1871, first became an active company in connection with the Reading reorganization in 1896 (Record, p. 2). Prior to that reorganization, its capital stock had been only $100,000; as part of the reorganization its capital stock was increased to $140,000,000, and, as part of the consideration for the issue of this stock, the stock of the Railway Company and of the Coal Company was transferred to the Reading Company (Record, pp. 158, 160). The Reading Company thereby became and has since continued to be a holding company, controlling two separate businesses. It is not, and never has been, an operating company. This combination of two businesses through stock ownership is the essential characteristic of the present Reading Company, the chief, if not the sole, reason for its existence (Record, p. 8), and it is this combination which the Mandate of this Court has ordered shall be dissolved (Record, p. 27).

This Court ordered the dissolution of the combination between the Reading Company, the

Railway Company and the Coal Company, etc., "with such provision for the disposition of the shares of stock and bonds and other property of the various companies, held by the Reading Company, as may be necessary to establish the entire independence *from that company and from each other,*" of the Railway Company and the Coal Company, etc. (Record, p. 25). Subsequently the Reading Company made a motion to be permitted to retain either the Railway Company or the Coal Company. The motion was denied by this Court. *United States* v. *Reading Company*, 253 U. S. 478.

Aside from its functions as a Holding Company the Reading Company's tangible assets include only certain rolling stock and floating equipment (Record, p. 8) useless to it after compliance with the decree and indispensable to the Railway Company. Therefore, though the decree explicitly required only the disposition of the Holding Company's holdings of stocks and bonds its inevitable practical effect was to require the disposition also of its tangible assets. Mr. Justice Clark had said of the Railway Company (Record, p. 7):

> "* * * But by the plan of reorganization adopted it was disabled from performing its functions as carrier, except with the aid of the Holding Company, for all of the equipment, engines, cars and ships, owned by the former Railroad Company, and its tidewater terminals at Philadelphia and on New York Harbor, were allotted to the Holding Company."

Obviously a plan which left the Holding Company the owner of the equipment would have contravened the spirit of the decision of this Court, as well as every consideration of practical expediency. The equipment would be useless to the Holding Company after dissolution and indispens-

able to the Railway Company. The decree of this Court then did really involve the utter liquidation of the Reading Company, the Holding Company.

The rights arising upon the Mandate of this Court as between the stockholders of the Reading Company are therefore those which arise in case of liquidation or dissolution. The rights became fixed by the Mandate of this Court and it became the duty of the Reading Company in formulating any plan in the execution of that Mandate to treat the rights of the stockholders *inter sese* accordingly.

Prima facie it seemed that the inevitable consequence of the decisions of this Court was to sell the stocks of the Railway Company and the Coal Company (or certificates of interest therein) or distribute them to the stockholders of the Reading Company, following the precedent established in the Northern Securities Case, (*Northern Securities Company* v. *United States*, 193 U. S. 197; *Harriman* v. *Northern Securities Company*, 197 U. S. 244, 256), modified, however to comply with the precedent established in the Union Pacific-Southern Pacific case, (*United States* v. *Union Pacific Railroad Company*, 226 U. S. 61, 470), so as to require the stockholders to dispose of one or the other. The consequence would have been to relieve the preferred stockholders of the Reading Company of the 4% limitation upon their participation in the earnings of the Railway Company, which the present Plan does not do; and in addition to give them full participation in the proceeds of the coal property, whereas their participation, under the present Plan, in the coal property or its proceeds is limited to the excess of its value over $40,600,000

in cash and bonds retained in the treasury of the Reading Company. The *prima facie* plan, however, would have made it difficult to avoid disturbing the General Mortgage of the Reading Company under which $93,000,000 of bonds, having 75 years to run, at 4%, are outstanding (Record, p. 157). The common stock would have everything to lose by such a plan, whereas the preferred would have much to gain and nothing to lose. The board of directors, however, approached the problem, not so much from the point of view of the interests of one or another class of stock as of the wise disposition of the sundered fragments of the properties. Accordingly they promulgated the present Plan, involving the merger of the Railway Company into the Reading Company and the surrender of powers inappropriate for a railroad corporation, to meet the requirements of the Mandate of this Court without disturbing the General Mortgage—a plan much less advantageous to the preferred stock.

Curiously enough it is precisely upon this feature of the Plan—the merger of the Railway Company, instead of the disposition of its stock to Reading stockholders or otherwise, followed by the usual corporate proceedings for the dissolution or reduction of capital stock of the Reading Company—a feature conceived in the interest of the conservation of the property and at the expense of the preferred stock, that the appellants really rest their case when they claim that the Plan does not involve a liquidation or dissolution of the Reading Company.

It becomes appropriate to examine just what this merger is in form and effect which the appellants rely upon to convert the consequences of this Court's dissolution decree into an extra divi-

dend for the common stock;—it becomes necessary indeed to do so for the appellants are under evident misapprehension about it.

The brief submitted on behalf of the Insurance Companies, erroneously states (p. 3) that under the Plan the Reading Company is to retain its charter. This Court has called attention to the fact that the Reading Company is a holding company having a special "omnibus" charter entitling it to engage in, or control, almost any business other than that of a bank of issue (Record, pp. 8, 20). It is not a common carrier and is not subject to regulation by Federal or State authorities having jurisdiction over railroads (Record, p. 157). It is of the very essence of the Plan, of the Government's consent and approval of it, and of the Decree of the Court below, that the Railway Company shall be merged into the Reading Company and that the Reading Company shall cease to be a holding company, surrender its extraordinary powers, and become a railroad company in all respects subject to the regulation of State and Federal authorities as a common carrier (Record, pp. 43, 277).

The merger will be made under the power contained in the charter of the Reading Company,

> "* * * to merge or consolidate, or unite with the said company the improvements, property and franchises of any other company or companies, on such terms and conditions as the said company may agree upon; * * * " (Record, p. 193).

The surrender of all powers inappropriate to a railroad corporation will be made under the Pennsylvania Act of 1856, which provides as follows:

> "Section 1. *Be it enacted by the Senate and House of Representatives of the Com-*

monwealth of Pennsylvania in General Assembly met, and it is hereby enacted by the authority of the same, That it shall be lawful for any court of common pleas of the proper county to hear the petition of any corporation under the seal thereof, by and with the consent of a majority of a meeting of the corporators, duly convened, praying for permission to surrender any power contained in its charter, or for the dissolution of such corporation; and if such court shall be satisfied that the prayer of such petition may be granted, without prejudice to the public welfare, or the interests of the corporators, the court may enter a decree in accordance with the prayer of the petition, whereupon such power shall cease or such corporation be dissolved: *Provided,* That the surrender of any such power shall not in any wise remove any limitation or restriction in such charter; and that the accounts of the managers, directors, or trustees of any dissolved company shall be settled in such court, and be approved thereby; and dividends of the effects shall be made among any corporators entitled thereto, as in the case of the accounts of assignees and trustees: *Provided further,* That no property devoted to religious, literary, or charitable uses shall be diverted from the objects for which they were given or granted: *Provided,* That the decree of said court shall not go into effect until a certified copy thereof be filed and recorded in the office of the secretary of the commonwealth." (Laws of Pennsylvania, 1856, p. 293, No. 308).

The acceptance of the Constitution of the State of Pennsylvania will be made under the Pennsylvania Act of 1874 which provides as follows:

"Section 1. *Be it enacted,* etc., That it shall be the duty of the board of direc-

tors of any railroad, canal or other transportation company in existence on the first day of January, one thousand eight hundred and seventy-four, desiring to accept of the provisions of the seventeenth article of the constitution of the state, adopted on the sixteenth day of December, one thousand eight hundred and seventy-three, to file in the office of the secretary of the commonwealth a certificate in writing, signed by the president and secretary, and attested by the corporate seal of the company, stating that at a regular or special meeting of said board of directors a resolution, in pursuance of the consent of the stockholders, was adopted, accepting of all the provisions of said article; and all the powers and privileges, and the limitations and restrictions mentioned therein, shall be deemed and taken for all purposes to apply to said corporation; the said certificate shall be recorded in the office of the secretary of the commonwealth, in a suitable book to be by him kept for that purpose."

"Section 2. No such certificate shall be made by the officers aforesaid, without the consent of the stockholders of the corporation, to be obtained by an election to be held in the same manner as prescribed by law for increasing the capital stock of a corporation." (By the consent of a majority of the stockholders.) (Laws of Pennsylvania 1874, p. 275, No. 157).

After such action the company formed by the merger will have no powers except those granted to railroad companies incorporated under the general laws of Pennsylvania.

Under the law of Pennsylvania whenever there is a union of two or more corporations, the resulting corporation is a new corporation, distinct from any of the original corporations. This is

true whether the union be called a merger or a consolidation; the two terms are interchangeable. *Lauman* v. *The Lebanon Valley Railroad Company*, 30 Pa. St. 42; *Dalmas* v. *Philipsburg & Susquehanna Valley Railroad Company*, 254 Pa. St. 9; *Pennsylvania Utilities Company* v. *Public Service Commission*, 69 Pa. Sup. Ct. 612.

The case of *Lauman* v. *The Lebanon Valley Railroad Company*, 30 Pa. St. 42, was a bill to enjoin The Lebanon Valley Railroad Company from merging with the Philadelphia and Reading Railroad Company, under a special Act of Assembly which gave them power to merge. The Court said on page 45:

> "This is called a merger of the Lebanon corporation into the other; but such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved."

In the case of *Dalmas* v. *Philipsburg & Susquehanna Railroad Company*, 254 Pa. St. 9, the Court discussed merger under various acts, including the Merger Act of 1865. An interpretation of the word merger as used in these acts passed both before and after the Charter of the Reading Company is an aid in the construction of the legislative intention in the use of the words "merge" and "consolidate" in that Charter. The lower court (its opinion was adopted by the upper court, which affirmed the decision without an opinion), said on page 15:

> "When two or more corporations merge, the presumption is that all of the property of each constituent company is transferred to and becomes the property of the new company, and that from the time of the completion of said merger the constituent companies cease to exist so far as the terms of the act of assembly, under which

said merger is effected, preserve their existence; and in order to overcome this presumption there must be a saving clause in the merger proceedings. No such saving clause appears in this bill."

There is no such saving clause in the Charter of the Reading Company (Record, p. 189).

In the case of *Pennsylvania Utilities Company* v. *Public Service Commission*, 69 Pa. Sup. Ct. 612, the lower Court cites *Lauman* v. *The Lebanon Valley Railroad Company* with approval in discussing the Merger Act of 1909, Pennsylvania Laws, p. 408, No. 229, which provides:

"Section 1. Be it enacted, &c., That it shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made:"

The Court said, page 618:

"It is clear the ultimate effect of this act is to provide a method of incorporation, and, as individuals are associated to form a corporate entity, so two or more corporations may be associated to form a single corporate entity. Upon consolidation thereunder the constituent companies are deemed dissolved and their powers and faculties to the extent authorized are vested in the merged company as a new corporation. It is an entity entirely distinct from

> that of its constituents. It draws its life from the act of consolidation. The fact that to ascertain the powers and faculties of the new company you must be referred to what existed in the old companies does not affect this result: * * * "

The Reading Company will thus be deprived, by the decision of this Court, and the execution of the Plan, of its properties, its corporate powers, its corporate existence even. Though the proceedings take the form of a merger by the Holding Company of the Railway Company, a new corporation will result from these proceedings, and that not a holding company but a railroad company.

Having regard then to the purposes for which it was formed, or reformed, in 1896, to its status and its corporate history as a holding company organized and operated (in the words of Mr. Justice Clarke—Record, p. 9) "for producing, purchasing, and selling coal and for transporting it to market" through the railroad and coal companies as its agents or instrumentalities, "the mining and transportation departments of its business"; having regard also to the utter disintegration of this business which the decree directs and the Plan effects, and to the termination of the corporate powers and the very corporate existence of the condemned holding company; it is apparent that the decree directs and the Plan effects not only a technical, but also a very complete and practical dissolution of the Reading Company.

The Reading Company believes that the rights of its stockholders in the situation created by the direction of this Court "dissolving the combination * * * existing and maintained through the Reading Company" and directing that its

properties be disposed of, and under the present Plan which carries out the Mandate of this Court, are determined, not by the rule governing dividends from current earnings, but by the rule governing the disposition of assets.

Conclusion.

The Decree of the District Court approving the Plan should be affirmed.

Respectfully submitted,

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